

CREATING THE EAFTA

October 27, 2005

Thursday, October 27th 2005

Opening Remarks by

Dr. Kyung Tae LEE, President, Korea Institute for International Economic Policy (KIEP)

After thanking Mr Hatakayama for giving KIEP the opportunity of participating in the symposium, Dr Lee welcomed all delegates and hoped that the symposium would act as:

“...a stepping stone to transform a series of bilateral Free Trade Agreements (FTAs) in East Asia (EA) into a single EAFTA.”

He also hoped that the symposium may encourage leaders in the region to realize the urgency of an EAFTA. He hoped Dr Supachai as the UNCTAD representative would convey this message of urgency to regional leaders. Since 2001 significant progress has been made in FTA negotiations between ASEAN and Japan, Korea and China, but he hoped that;

“...in five years an EAFT Area will be in existence.”

He outlined the ultimate goal as an East Asian “single market” with a free flow of goods, services, capital and people across borders. Although realizing this aim as ambitious, he believed it could be possible with standardized domestic economic policies. He encouraged inter government dialogue on this issue.

He outlined the role of Korea as a “bridge between Japan and China,” as Korea already had in place negotiations for FTAs with both Japan and China. Finally he paid tribute to JEF under Mr Hatakayama for its contribution to the future formation of an EAFTA.

Mr. Noboru HATAKEYAMA, Chairman and CEO, Japan Economic Foundation (JEF)

After welcoming delegates, Mr Hatakayama reflected on the previous JEF symposiums in Singapore 2003, Bangkok 2004 and Manila 2005 and their steps towards an EAFTA. He said that Seoul had been chosen as the current venue due to the importance of the South Korean economy. He recalled his involvement with JETRO's Institute of Developing Economies (IDE) in conjunction with Korea Institute for International

Economic Policy (KIEP) to examine the economic feasibility of an FTA between Japan and Korea.

He outlined the advantages of FTAs examined at all previous symposiums, “showing opportunities for new business.” He stressed the importance of launching a “study and negotiations” on an EAFTA.

**Keynote Address by Dr. SUPACHAI Panitchpakdi
Secretary-General, United Nations Conference on Trade and Development
(UNCTAD) (Former Director-General of World Trade Organization)**

“Regional Integration”

Dr Supachai started his keynote address by joking of his various roles in international organizations, posing the question of where you might do the most good. He cited his work in WTO, IMF and UNCTAD. He then asserted that: “if you want to make globalisation work for everyone in this world, then all the institutions have to work together.”

He then referred to a speech made at a Texas university, which had conferred an honorary Doctor of Laws in 1974 upon Harry Truman. In support of an international, multilateral system, he asserted that: “Peace, freedom and trade are completely inseparable.”

Dr Supachai referred to the Free Trade Area of the Americas which was on and off for several years. After Cancun 2003, it wasn’t successful due to the big gap between the US and Brazil on several issues. There was no interest in pushing the FTAA as the Central America FTA (CAFTA) had already been signed. Multi track negotiation was required. Agriculture remained the biggest hurdle. Dr Supachai spoke of the need to work quickly to achieve success in the upcoming Hong Kong talks. He commented that when countries of different levels of development are negotiating, it doesn’t give a “balanced outcome.”

He spoke of a failed attempt to set up a council to monitor ITAs and FTAs under the WTO, because countries didn’t want their reviews on a “peer basis.” He observed that in the liberalization process globally, 60% of the liberalization came from unilateral efforts and 30% from multilateral negotiations. The remaining 10% originated from a “plethora of hundreds of negotiations. Many places have “ambivalent feelings on regional integration.”

He then related a story of a recent ministerial meeting discussing key areas of market access on agriculture and manufacture. The minister from the US, Rob Portman, had to leave to vote on an important Congress vote on CAFTA, which was passed by just two

votes. Dr Supachai observed that if CAFTA hadn't passed Congress then the upcoming Hong Kong Ministerial Meeting would have been useless. There is an interplay between regional integration and multilateral integration. He said, "Most of the time, you are concerned with regional integration because there is no-one to monitor what is going on." He urged all delegates to go to Geneva for a "pre-cooked" solution to the Hong Kong Ministerial in order to achieve real progress.

He then went on to say that, "Although I know that your efforts in EAFTA are really laudable, we at UNCTAD believe that this new geography of trade indicates that trade groups will have multi-polar systems; not only US or EU but Asia, South Asia or East Asia." He further asserted that all these Asian regions will remain growth centers for the global trade system.

Dr Supachai then posed a series of questions to the symposium, ie:

1. What is the proposed coverage of EAFTA? Is it purely trade or "trade plus," for example financial, investment agreements, social clauses?
2. What will be the membership?
3. How will you handle disputes?
4. What is the basic motive behind the EAFTA? Is it economic or political?
5. What is the time frame?
6. What is your response to "rules of origin?"
7. What is the proposed impact on Australia and New Zealand? Will it divert trade from them?
8. Is your intention to keep it select, for example "ASEAN + 3" or open it up to countries like India?

He finishes his keynote address by wishing the delegates success and offering the help of UNCTAD. "Regional agreements can be very beneficial."

Moderator:

Dr. Kyung Tae LEE, President, Korea Institute for International Economic Policy (KIEP)

Question and Answer

Dr Lee marvels at the number of questions posed by Dr Supachai and comments that maybe a new impetus will emerge, for example US and Brazil.

A questioner comments that in his view "investment is crucial" whether across borders or beyond borders. He asserts that "harmonization has been ignored" and worse still, investment issues have been subdued or not considered. He asks Dr Supachai for his views on this.

A new questioner asks Dr Supachai's position on Article 24 of the GATT Agreement. "Have you been trying hard to strengthen discipline for or against FTAs?"

In responding to these questions, Dr Supachai responds first to the question on the Doha Development Agenda (DDA). He stated his own view that when members of the WTO are driven into a corner, they "can't possibly fail, they will be inventive about solutions." He then goes on to say that the likely outcome of the Hong Kong Ministerial will be some success or progress but concedes that the agricultural negotiations won't be clinched. This would be impossible. He noted that June 2007 represents the limit of the round. He noted that there was bipartisan support in US for trade liberalization, but that Congress might make it harder. He feels that we may have to "dilute reform proposals but there is the hope of rejuvenation for all FTAs."

On the question of the investment issue, Dr Supachai agreed that "investment is the key area" and must be central to any FTA. He cites ASEAN as attractive because of investment opportunities. Unfortunately, in Africa intra-regional trade is not significant.

On the question about Article 24, posed by Mr Hatekayama, Dr Supachai said a lot of effort had gone in to honouring Article 24. He poses the question of how to go about setting up notification procedures. He also believes you need a monitoring process to see if you are complying with the basic ruling. Such a process doesn't exist at the moment. He then warns that what he is about to say is "dangerous talk." He suggests taking one FTA to court to a panel. If the case is lost, you can see how this would help to disintegrate the whole system.

Session 1: Bilateral and regional FTAs in the region

i) Assessment of the FTAs already in force in the region

ii) Difficult issues for many FTAs to cope with (WTO compatibility and other issues)

Moderator:

Prof. Simon SC TAY, Chairman, Singapore Institute of International Affairs (SIIA)

[Dr Hank Lim is announced as the replacement moderator.] He commends Dr Supachai's overview and perspective from a multilateral view in regard to trade liberalization. He goes on to say that Dr Simandjuntak's paper will be read. He hails the panelists as key players in assessing current FTAs in place in the region and analyzing difficulties faced by FTAs.

In the current FTAs in the region he says we have a multi-layered, non-integrated and various bilateral versions and exemplifies these as China ASEAN, China Japan and ASEAN Korea. He poses the question of how to negotiate and create a framework where all the different layers will converge into an EAFTA with bilateral, regional and sub-regional objectives. He then calls upon the panelists to outline their structural

roadmaps. He adds that some agendas differ, for example economically or politically. He hopes the issues of:

- Rules of origin
- Investment
- Dispute settlement mechanisms

will be “put on the table at the outset.”

Panelists:

Dr. Chulsu KIM, Senior Advisor, Lee International (Former Minister for Trade-Korea)

He outlines his role as explaining the status of Korea’s FTA initiatives and explains that the other panelists will do the same for their countries.

Korea concluded its first FTA with Chile in 2003 and formulated a “comprehensive FTA roadmap for Korea.” This included:

- Korea should pursue FTAs actively and strategically
- Korea should seek a high level of liberalization
- Korea should pursue multiple fronts with its key trading partners.

On the basis of this roadmap Korea has engaged in FTA initiatives with some twenty countries. It began negotiation with such countries as Japan in December 2003, Singapore in January 2004 and Canada in July 2005. Also on the table is India and Mexico as a forerunner to a possible FTA with the US. At a private level, joint level discussions have been held with China and Korea is also participating in a study for a trilateral Japan, Korea and China agreement.

Dr Kim observed that there had been varying levels of success. For example Korea concluded and signed the FTA with Singapore in Aug 2005 and has completed four rounds of negotiations with ASEAN to date with a view to fully implementing the FTA 2009. Korea hopes to conclude its agreement with Canada by mid 2006 as its first North American partner.

However, the Korea Japan FTA has been “deadlocked” for more than a year after three rounds. Agriculture is the main problem but others exist as well. So it seems to be impossible to complete the original schedule by the end of 2005. Efforts from both sides are pushing to resume talks.

Dr Kim then summarises two successful FTAs, namely Korea Singapore and Korea EFTA (European FTA). In the case of Singapore, Korea will remove 91.6% of its tariff lines in ten years with 60% taking immediate effect. He cites the practice of treating products from special economic zones such as Kesong as South Korean products. The KSFTA contains a “high level of liberalization in areas of services and investments

through a negative list approach” except in financial services “where a positive list will apply.” The KSFTA contains a great deal of “WTO plus elements” eg:

- Investment
- Government procurement
- Mutual recognition of standards and conformance procedures
- Property rights

Economic promotion elements promoting trade and investment, science and technology, human resources, development, transportation, environment, energy and others.

In the case of KEFTA, the agreement was swiftly concluded in six months. It was Korea’s first FTA with a group of industrialized countries from the EU trading bloc. A higher degree of liberalization was required than for either Singapore or Chile. Korea had to eliminate tariffs on industrial products in seven years, 91% immediately; 88% of fishery products and 84% of processed agricultural products in ten years. A separate schedule of agricultural products was negotiated similar to the Kesong manufactured products. If more than 60% of a product is made in South Korea, then it qualifies as a South Korean product.

There was high liberalization in trade, services and investment. It contained several WTO plus elements, for example “competition policy and intellectual property rights.”

Dr Kim then outlined the current priorities and challenges facing Korea’s FTAs:

- Ratification of the Singapore Agreement in the National Assembly before the end of 2005
- Accelerating negotiations with ASEAN and Canada to finish by 2006
- Reviving the deadlocked FTA process with Japan
- How to begin an FTA negotiation with the US (“maybe the greatest challenge!”)

Dr Lim thanks Dr Kim and points out that Korea has a very “strategic role” in negotiating North East Asia FTAs, by using the Korea Singapore template. He points out that there is already a precedent for an “integrated sourcing initiative” in the US Singapore FTA. He adds that maybe the lessons learned on agricultural issues with the KEFTA may be beneficial to Korea Japan negotiations.

Mr. Nobuhiko SASAKI, Deputy Director General, Trade Policy Bureau, Ministry of Economy, Trade and Industry (METI-Japan)

Mr Sasaki explains that he will make extensive use of the precirculated booklet in discussing Japan’s policy situation on FTAs and EPAs.

He explains that page 10 shows “how our economies are integrated by trade in this region.” The diagrams on this page show a comparison between 1990 and 2001. In the

trade flow diagram of general machinery parts, in 1990 “there was only one strong trade flow” namely Japan to ASEAN. By 2001 this had become a two way trade flow. Also there were stronger trade flows between Japan and China and ASEAN and China. Korea isn’t shown in this chart but shows a similar pattern. The electrical machinery parts show similar strengthening over the ten years and he concludes “All this happened by investment.” Japan and Japanese companies had invested heavily in these regions.

Page 11 shows Japan’s direct investment into East Asia has increased in contrast with a decrease in Japan’s investment into EU and NAFTA countries. So East Asian countries have become much more important production places for Japanese companies.

Page 12 shows the challenge for the Japanese Government. Japan started FTA negotiations in 2000 and their efforts “institutionalized de-facto based regional economic linkages in East Asia.” This occurred by increasing investment. Concrete actions included:

- Intensive negotiation for tariff elimination of parts/components rather than of final products
- Japan strongly pursued an improvement of investment-climate of the East Asian area by establishing investment rules and framework for discussion among both governments and investors.

“We are more interested in EPAs rather than FTAs.”

Page 13 gives a definition of FTAs and EPAs. Japan’s first agreement with Singapore is an EPA. An EPA includes the core of FTAs, namely the elimination of tariffs. It also includes such factors as:

- Relaxation or elimination of domestic regulations
- Harmonization of economic systems
- Facilitation of movement of natural persons

The purpose is to “institutionalise the de-facto linkage of this region.”

Page 14 shows the precise contents of the EPAs. “I’ll skip this page for the sake of time, but EPAs and FTAs being pursued by Japan are not only for the elimination or reduction of tariffs but also for providing Japanese companies and their counterparts a better business environment in this region.”

Page 15 shows Japan has reached an in principle agreement for bilateral FTAs with The Philippines, Malaysia and Thailand and has now started negotiations with Indonesia and ASEAN. Mr Sasaki points out that it is “a big challenge to merge bilateral FTAs which are already in place for a whole regional FTA.”

Page 16 outlines Japan’s EPA negotiations with non ASEAN countries. Mr Sasaki calls for the deadlocked negotiations with Korea to resume as soon as possible, not only for Japan and Korea’s sake, but also to become a core for the ASEAN + 3 EAFTA. Japan is

currently holding joint study groups for possible FTAs with India, Chile, Australia and Switzerland.

Page 17 explains Japan's current schedule.

Page 18 is a lesson from Japan's experience of difficulties encountered in the "negotiation process." Both parties have sensitive issues or sectors. These are "often obstacles to ambitious EPAs with other parties. Due consideration for sensitive sectors of other parties is necessary to reach a win-win conclusion." Differences in the stage of development among countries is another "obstacle to an ambitious FTA," for example the protection of intellectual property rights and competition policy. Mr Sasaki feels you need "wisdom to deal with these issues."

"We are now building blocks to achieve an FTA in this region and achieve a model FTA in the East Asian region."

Dr Lim responds that he is pleased to know that Japan's approach is also focusing on EPAs, which "involves facilitation and development agendas" particularly with the CLMV countries. He adds that Japan has specific programs to be put up in the summit in Kuala Lumpur. These include not only reducing tariffs, but also addressing:

- Development
- Technical facilitation
- Mutual recognition.

"If harmonization is not the first order then it is the second order." He notes that as the most developed economy in the region, Japan has a very "special role to play in building up the EAFTAs. He thanks Mr Sasaki for providing the framework and strategies of Japan's FTAs and EPAs and introduces the last panelist, Professor Zhang.

Dr. Djisman SIMANDJUNTAK, Chairman, Board of Trustees, Department of Economics, Center for Strategic and International Studies (CSIS-Jakarta)

[Paper not delivered due to a delay in arrival of his plane]

Prof. ZHANG Yunling, Director, Institute of Asia-Pacific Studies/ APEC Policy Center, Chinese Academy of Social Sciences (CASS)

Professor Zhang announces he is going to start from a regional perspective, rather than from China. He says his first task is to "learn the current situation facing some challenges." He adds that there is increasing regional economic integration, but on the other hand still fragmented FTA efforts. "We have to find an integrated approach." He says that countries' priorities differ. For example a country such as Japan is more

concerned about harmonization, but developing countries are "more focused on market access." "The regional arrangement is much beyond trade creation." One key role he identifies is not just trade creation efforts, but also increasing the efficiency and help upgrade the systems of less developed countries. An EAFTA would "benefit all players."

Korea and China have already shown ways to solve their own problems in their regional arrangements, but "we can't wait for the completion of all these bilaterals. It will be too late!" Prof Zhang feels that a new agenda is needed to promote it. "Fortunately last year the economic ministers made a joint decision to set up a joint expert group, chaired by me, on a feasibility study." There were members from all thirteen countries. Prof Zhang maintained that the best approach is "to put the three 10 + 1's together. The timetable is very clear. All three 10+ 1's will be completed by 2007.

Prof Zhang then announces he will elaborate on some ideas. In terms of North East Asia, he poses the question of whether Korea, Japan and China can negotiate a trilateral FTA before undertaking an EAFTA. "We have two bilaterals, one bilateral is left behind, ie China Japan." He observes that it won't be possible to conclude a trilateral before 2007. More feasible is three 10 + 1's and then launch a trilateral program in 2008. He adds that there is something to be learned from the China ASEAN FTA where trade in goods is addressed first and then investment and services later.

Prof Zhang says "we need an EPA first and to consider the differences in economic development." He promotes signing a framework agreement in 2008 including an "early harvest program." He believes this will be an important confidence building for all the countries to feel the benefits. He thinks preferential treatment needs to be given to the CLMV countries. A time frame of EAFTA negotiations is needed as well as economic cooperation. He suggests that negotiations should be concluded by 2010 and the FTA should be in place by 2018 or 2020. The scope of the FTA should be comprehensive, including:

- Goods and services
- Investment
- Labour mobility
- Harmonization of customs procedures
- Integrated rules of origin
- Regional dispute settlement mechanism (as per China ASEAN)

As far as China's FTA strategy, Prof Zhang says you can read it but essentially China has a broad strategy with WTO commitment. China considers East Asia as a priority as well as Asia Pacific. It already has bilaterals with more than 25 countries, so what should it do now?

Prof Zhang says we need to confirm the schedule of the three 10 + 1 FTAs. Bilateral arrangements need to be coordinated. A clear strategy should be set up for the post

summit agenda, which includes all members. His personal preference is for 10 + 3 to be first achieved to make East Asia as a fact.

Question and Answer / Open Discussion

Dr Lim comments that the three panelists have provided some very “interesting roadmaps.” He asks for questions from the floor and collects four separate ones, which he then opens up to the panelists for comment.

Question1. This question is for Mr Sasaki. I think Japan’s EPA approach is good but what about an implementation mechanism or enforcement mechanism? For example in the case of Japan and Singapore, they agree to harmonize their domestic regulatory system, which can only be done by changing the domestic policies. Without a supervising institution, how do you guarantee to implement after the EPA?

Question2. This question is for Dr Kim. How do you accommodate the agreement without violating the MFN (Most Favoured Nation) rules?

Question 3. This question is for Prof Zhang. Is the present China ASEAN FTA working well? Are there still some problems?

Question 4. How do the three panelists feel about preceding an EAFT Area with an East Asia early harvest program? There is the possibility of a bigger FT area where in an early harvest program, each country offers a number of items to be tariff free and other harmonization and standardization practices.

Dr Lim replies that there is an absence in East Asia of creating “public goods” because it relies on market forces. There is no notion of the EU or other integrated regional cooperation. Early harvest can also be interpreted as East Asia public goods. Dr Lim then cites the example of the Japan Singapore agreement on mutually recognized standards of professional qualifications being subject to arbitrary Japanese decisions on for example Singapore doctors.

Dr Sasaki replies that in the Japan Singapore agreement there is an annual ministerial meeting to review. A similar article is now being applied to all the other Japan bilaterals. The “business environment” is discussed by representatives of both governments and private businesses every few months. There are mechanisms in place to “enforce the agreement.” In response to the early harvest, it means it is difficult for developed countries to conclude without going against GATT Article 24.

Dr Kim says how can we justify the Kesong rules? The question of most favoured nation is discussed in the Korea ASEAN agreement. Dr Kim asserts that the Kesong rules are at least accepted. In terms of the early harvest, He doesn’t know what is in the

minds of the Korean negotiators, but the agreements must reflect “different levels of economic development.” Differential liberalization schedules must be reflected. “I endorse this.”

Prof Zhang says that there are no major problems in the China ASEAN FTA. He believes that for an early harvest program, “if we have EAFTA agenda, we have to put this into a general framework. One possible way is to survey each country’s major concerns. He suggests liberalizing some sectors earlier and be aware of economic assistance and development.

Session 2: What is ASEAN Economic Community?

Moderator:

Mr. Noboru HATAKEYAMA, Chairman and CEO, Japan Economic Foundation (JEF)

Mr Hatekayama opens this session by saying that an EAFTA should be easier to create than a “community.” After the Manila Symposium he met three ASEAN leaders and asked them “What is the AEC?” They all replied that it is like an ASEAN FTA including services and investment sectors and maybe plus others.” This is not a community!” ASEAN countries are not ready to concede part of their sovereignty to the Secretariat. My current thinking is that it is an AEC is much easier than an EAFTA, because an AEC might be part of EAFTA. “Am I right or wrong?”

Panelists:

**Dr. Thomas G. AQUINO, Undersecretary, International Trade Group (ITG)
Ministry of Trade and Industry-Philippines**

Dr Aquino says that this not an easy question to answer. He refers the audience to page 33 of their booklets and says he will base his talk on the matrix on that page. This shows how over time ASEAN has evolved as far as EAFTA and a desire for an AEC is concerned.

On the vertical axis of the matrix, the progress is shown from a FTA to an EPA and finally an Economic Community. The horizontal axis shows the geographic scope with ASEAN as the starting point, then + 3 and then the others.

The ASEAN FTA started in 1992 with goods and services are now being worked upon. Investment agreement was signed in 1998. Then under the ECP, in 1998 ASEAN leaders called for an “ASEAN vision.” There were different dialogue partners including China, India, Japan and Korea and talks went beyond goods, services and investment.

Then the Economic Community is defined as an area where there is “practically a free flow of goods and services.” The vision is of a stable, prosperous region with a freer flow of capital and equitable economic development, which reduces poverty and socio-

economic disparities. To reach this vision requires a number of steps. In his paper Dr Aquino outlines the steps for a FT area on goods, investment and services together with plus elements with other dialogue partner countries. A decision must be made on the role of the Secretariat. Maybe ASEAN can address the sovereign issues called for by the economic community in an ASEAN way?

H.E. Mr. ONG Keng Yong, Secretary-General, Association of Southeast Asian Nations (ASEAN)

Mr Ong says to answer the question it is best to develop a negative list approach. Thus an AEC:

- Is not a common market
- Is not designed to create a fortress (ie non exclusive)
- Is not the EU
- Is not a super national structure

He goes on to say that ASEAN leaders do not want to cede any power to the Secretariat, whereby it has the right to rule the roost on issues within their own borders. He cites two examples of the Secretariat limiting Thailand's rice export or telling Singapore to open up its labour market. The Secretariat would have the power to punish non conformers like the EU has in their rules as interpreted by the European Commission. This is not the desire of ASEAN leaders.

On the contrary ASEAN leaders want a market place, which is a free open space with a minimum of restrictions and gives businessmen a chance to "exploit the economy of scale." Thus the AEC is not a rigid concept but a free flowing "typical South East Asian concept." Mr Ong likens it to a typical "flea market" where everyone is free to buy or sell, there aren't too many rules and people don't cheat or do anything illegal. "The whole idea is the opportunity available and to decrease the cost of running a business." The overriding concern is "How to make SE Asia competitive?"

There are ten countries in SE Asia and customs clearance is a big issue. He contrasts this with big markets such as China or India. It is too expensive in SE Asia to produce food in one country and export it elsewhere in the SE Asian region. Political boundaries must be removed to create one market place. Thus the AEC is really a market place with a minimum of restrictions.

Mr Ong then says that the word "community" is maybe not used in the same sense as it is elsewhere. The ASEAN leaders mean by community:

- A collective (ten together)
- A responsibility to keep the market place open for trade in goods, services and investment.

As a collective, you have better bargaining power with developed countries or bigger Asian neighbours. The aim is to broaden the space for our investors. “The key word is competitiveness.” Emphasis on the AEC by 2020 will be based on three pillars:

1. Political and security cooperation
2. Economic cooperation and integration
3. Social and cultural development

“The term “community” seems to be creating confusion.”

Question and Answer / Open Discussion

The first question is posed by Dr Lim. He states there are three conditions required for regional trading arrangements:

1. Reduce cross border measures
2. Beyond border measures such as competition policy and dispute mechanisms must be in place
3. Harmonisation. If you can’t get this then it is difficult and you must settle for a second best option of a MRA (Mutually Recognised Agreement)

ASEAN has only done the first of these not the second or third. A “single market production base” to be competitive must have one price policy. He calls for a response from the panelists.

Mr Ong says in regard to Dr Lim’s first condition, ASEAN has done a lot. Regarding harmonization, “we have done a lot more than people realize.” He cites the harmonized tariff nomenclature. In regard to the MRA, ASEAN is making steady progress, for example in cosmetics and telecommunication.

“The main problem is enforcement.” We have 100% agreement but only 35% implementation. Customs administration is a major focus and will help in negotiations with China, Japan and Korea.

Dr Aquino adds that ASEAN has been born out of a “peaceful neighbourhood” which wants to work and live together. ASEAN has a lot of problems and there is a lot of work still to be done. ASEAN has gone through a “lot of self realization” and this could help in EAFTA negotiations.

The second questioner asks a question on the “concept itself.” He adds that in Europe they tried to have a common market and EU, whereas would it be more suitable to call the ASEAN model an “AEC” or just an “FTA +?”

Mr Hatekayama adds to this question and says, “If we are going to have an EA summit meeting for the first time in December on the East Asia Community, ASEAN countries are supposed to have an important role in this. Maybe EAFTA + at best.”

Mr Ong in response makes the following points:

- EAFT Area has nothing to do with the EA Summit. It’s a new thing.
- EAFTA is a long term measure recommended and endorsed in 2002
- The East Asia Study Group had 26 recommendations on a Vision group.
- An ASEAN + 3 could move to an East Asia community ie a development of EAFTA

He poses the question of how to engage Australia and New Zealand in an ASEAN + 3 Summit. He adds that terms are “used loosely.” The EA Summit is designed as a dialogue forum for leaders without their accompanying bureaucrats. India “feels left out.” Russia insisted on taking part. We need to foster closer interaction between China, Japan and Korea “without historical baggage and political problems.”

On the ASEAN FTA + question, he says it is unwanted. We are more interested in a “JEF type EPA.” In order to make progress, you need to bring people together on a commercial basis.” Political leadership has used “a difficult journey on an economic boat.” Bureaucrats will interfere. “Politicians don’t want to listen to technicalities.”

Session 3: Creating the EAFTA

- i) Timing of the Creation of EAFTA and an Integrated Road-map to Achieving it**
- ii) Members of EAFTA**

Moderator:

Dr. Chulsu KIM, Senior Advisor, Lee International (Former Minister for Trade-Korea)

This session will deal with three things:

- When can we achieve EAFTA?
- How do we get there?
- Who should be involved in EAFTA and how should they be involved?

Dr Kim outlined that there were a variety of initiatives being conducted in the region and the key question is how could these be integrated or “rolled into one” to bring about the FTA.

These discussions include:

- ASEAN+1 involving Japan China and Korea
- Korea and Japan (although deadlocked at the moment)
- Bilateral initiatives involving China and Japan on the one hand and individual ASEAN countries on the other

There are various scenarios for the development of the EAFTA. Alternative approaches could be:

- Press ahead with the present ASEAN+1 process and later add these negotiations
- Begin negotiations with the ASEAN+3 process
- The North East 3 countries to form an FTA and then integrate with the ASEAN countries subsequently
- Korea and Japan conclude an FTA later joined by China and then integrate this trilateral agreement with the ASEAN countries.

Membership questions are also complex and important. How countries should be treated?

- The question of Taiwan and North Korea
- Australia, New Zealand and India
- CLMV countries.

Panelists:

**Dr. Thomas G. AQUINO, Undersecretary, International Trade Group (ITG)
Ministry of Trade and Industry-Philippines**

“This is a formidable assignment to be able to answer all of these in 7 minutes!”

Regarding the selection of the pathways, Dr Aquino commented that considering the first pathway to press ahead with the ASEAN+1 negotiations would be reasonable, however each one of the +1 have there own independent process so it would be extremely difficult to get conclude with an integrated approach.

Using the ASEAN+3 approach, which Dr Aquino said is the one currently being followed and has momentum, then that is proceeding with what is already being followed.

On the third path of the North East Asia 3 to conclude an FTA and then integrate this with ASEAN, Dr Aquino commented that nothing prevents any of the three from establishing a FTA. However if there is an expectation of ASEAN providing an impetus or assistance as has been done in the past, then from a practical perspective ASEAN countries would be concerned about anything that would affect the stability of trade and investment in ASEAN caused by the results of agreement reached amongst any of the individual 3 countries.

Regarding the option of Korea and Japan concluding an FTA later joined by China and then reaching agreement with ASEAN, Dr Aquino felt he had limited background to make an “intelligent guess”. “It really depends on the desire of the parties involved”, he commented and if they do so then it will have a momentum of its own.

On the issue of membership, regarding China and Taiwan, Taiwan is not an issue. From the economic standpoint, nothing will prevent ASEAN countries from getting closer to Taiwan. But we need peace and prosperity in the region and to achieve this there should not be any area in the region that is not included in this big EAFTA. North Korea really depends on the Koreans themselves – how they see themselves and East Asia as a whole.

On the question of countries, which should be included in EAFTA Dr Aquino said that geography should be the determinant. “So there is an East Asia and a West Asia”. So if the country is in the West then “the answer is obvious”. Regarding CLMV countries, ASEAN has embraced CLMV from the beginning so Dr Aquino does not believe there is any issue with their involvement.

Mr. Noboru HATAKEYAMA, Chairman and CEO, Japan Economic Foundation (JEF)

Mr Hatakeyama discussed the two issues of the sequence of regional and sub-regional agreements and the membership of EAFTA.

In respect of the first issue, Mr Hatakeyama originally felt that EAFTA should be completed before the ASEAN Economic Community was established. However after hearing the ASEAN explanations about that Economic Community concept, it seemed that in the context of the range of agreements and discussions, he felt that EAFTA and the ASEAN Economic Community could compete with each other regarding their completion time. So the real answer will be that it should be on a “first come – first served basis”.

Regarding the key players for the membership of EAFTA, Mr Hatakeyama admitted there was not currently such a close relationship amongst Korea, Japan and China. So these countries may not be available to play a key role in the leadership of creation for the time being. So reliance would be on ASEAN to take the leadership. “So as Prof Zhang pointed out we don’t have to wait for every bilateral or sub-regional agreement to be completed to create the East Asian FTA.”

Thus Mr Hatakeyama felt that even in the absence of an agreement with the three North Asia countries it would still be possible to have an EAFTA. He instanced the case of Taiwan which, without other bilateral agreements could enter into WTO which is a broader mechanism. So Japan China and Korea could join into a broader EAFTA agreement without being a member of North East free trade area.

Regarding the membership of EAFTA there are two issues (i) participation of Australia, New Zealand and India. (ii) Taiwan issue.

On (i) Mr Hatakeyama commented that whilst he did not oppose their membership, as long as the name is “East Asia” then it would be difficult to justify participation from these countries. Regarding (ii) the GDP of Taiwan is bigger than those of any ASEAN country and it is located right in the middle of East Asia so it should be included as a separate territory just as its case with the WTO. “Taiwan should accept, for this purpose, the ‘one China’ principle.” Mr Hatakeyama felt that Taiwan should go back to the policy espoused more than ten years ago namely that in the future there would be one China. At the same time, the Government of China should be flexible in its definition of ‘one China’. It should be kept ambiguous so that the Government of Taiwan can have leeway in persuading the people of Taiwan about ‘one China’.

Dr. Chang Jae LEE, Director, Center for Northeast Asian Economic Cooperation, Korea Institute for International Economic Policy (KIEP)

Dr Lee spoke about the pathway and secondly his personal views on the membership issue.

The most ideal pathway is to accelerate the East Asian economic integration process through the existing ASEAN+3 framework. Another possible path is through a series of bilateral agreements. The third possible, theoretically, an EAFTA could be formed by a merger between AFTA and the newly created China-Japan-Korea FTA. (CJKFTA)

Based on the first stage of his Institute’s joint research on this topic along with organizations in China and Japan, the basic conclusion was that the three countries need to agree to a CJKFTA as a mid term goal before the establishment of an EAFTA.

[Insert Figure 2: note figure 1 is not used by this edited text]

The different pathways are shown in the attached figure. The most probable path according to Dr Lee is through a series of ASEAN+1 FTAs then forming an EAFTA. Another possibility, though less likely because of the stalemate amongst the Japan Korea FTA, is this developing to an EAFTA or for the same reason the formation of an CJK FTA leading to an EAFTA.

Another possibility is that Korea forms a FTA with China along with a Korea-Japan FTA leading to a CJKFTA or directly to an EAFTA. Nevertheless the final stage of the development of an EAFTA according to Dr Lee will come about through the ASEAN+3 summit meeting process.

The bilateral pathways described are likely to have some synergistic effects on the development of an EAFTA. Regarding the timing, Dr Lee personally expects that the

concluding of an EAFTA will occur by 2015. And regarding conclusion of a CJK FTA, Dr Lee's personal view is that this would occur by 2010.

On membership, there are several key issues. These include whether it should include countries beyond the boundaries of East Asia. A more fundamental issue is whether it should be 'inclusive' or 'exclusive'. Dr Lee's personal view is that the ultimate goal should be 'inclusive' including those outside the geographical region such as Australia, New Zealand, India perhaps US. But at the beginning it is better to start with core countries like ASEAN+3 then expand later. If all countries join from the beginning, he believes one could not expect a high quality FTA.

Mr. Vincent C. SIEW, Chairman, Chung-Hua Institution for Economic Research (CIER) (Former Premier of Taiwan Republic of China)

The first of the two issues brought up for discussion in this session is an examination of East Asia as divided into its Southeast and Northeast regions. ASEAN has already reached a fairly high state of formation, so the main question is how the three Northeast Asian countries can integrate both with ASEAN and among themselves.

All lines of discussion on this subject ultimately come to focus on China. For ASEAN, Japan and Korea alike, China is a market of major importance, both now and for the future. And for Japan and Korea, China is also one of their most important investment locations.

If we regard China as the hub, the most important of its relationships with other East Asian countries, besides Taiwan, is of course its relationship with Japan.

That is because Japan at present is the only country in East Asia that has greater economic, political and military clout than China does. Hence, Sino-Japanese relations have become the main key to East Asian economic integration.

Japan's economy has already started to climb out of its 1990s' trough. The result of its recent elections proclaims to the world that Japan is now set on course to reform its political and economic institutions. And Japan's resurgence augurs well for a much more dynamic role that it will play in East Asia than it has during the last decade.

Japan needs to take a broader and longer view of East Asian development. Naturally, its greatest concern must be the effect of China's rise. Besides its emerging vast market and investment opportunities, China's rise also brings many problems that affecting all the countries of East Asia that call for a common response from them.

The shortage of global energy resources due to China's galloping economic development has already had an impact on global economic development; China's foreign exchange, financial and capital market reforms have also affected the exports and foreign investment of all the countries in East Asia. Therefore it is our responsibility and our wish to see that China will maintain a stable development hence it

is in the interests of all the countries in the region to be helpful to China in resolving the important issues in their development. In particular, Japan needs to make the most of its influence, demonstrate goodwill, and rally all to act together in this effort.

Needless to say, the problems of Northeast Asia and Southeast Asia do not by any means bring to surface all the issues involved in East Asian economic integration. We need to integrate in a parallel pace (i) press ahead with ASEAN+1 (ii) Japan and Korea create an FTA then allow China to join it.

For one thing, although Taiwan plays a pivotal role in the Asia Pacific, it is missing from this picture. Hence, another main focus of this session should be the question of how to deal with China-Taiwan relations in the context of EAFTA. In fact, this question only addresses half of the issue; the other half is how the countries of East Asia should position Taiwan's role in East Asia's economy.

Let us consider the second half of the problem first. As we are aware, Taiwan plays a key role in East Asia's economy in production, investment and trade, and EAFTA would not be complete without Taiwan. Take Taiwan's IT industry as an example. According to a description in the US magazine *Business Weekly*, the 17-kilometer stretch of Taiwan's north-south expressway from Nangang to Hsinchu conceals the axis of the global economy. Taiwan's status in the global IT industry is as important as Middle Eastern oil to the global economy. Even in China, at least 40% and possibly as much as 80% of the exports of its increasingly important IT industry, are manufactured by Taiwan firms.

According to the latest statistics issued this year by Lehman Brothers, of China's 100 largest exporters in 2004, 21 were set up with capital from Taiwan, the number one foreign investor in China's industrial sector. Moreover, all of those 21 exporters were electronics or information companies, including Foxconn in first place, Quanta in second place, and Asustek Computer in fifth place. Other Taiwan-invested firms in the top twenty included Compal, BenQ, Mitac, Inventec and AUO.

Without Taiwan, EAFTA would not be complete. This is an important reason for the countries of East Asia to be concerned about cross-strait relations.

In the past year, cross-strait economic relations have taken an increasingly pragmatic slant. The first steps have been taken toward solving the problems of direct transportation, and Taiwan has been steadily lifting restrictions on cross-strait trade and investment. Even though China's passage of its so-called "Anti-Secession Law" generated some bad feelings on the cross-strait political front, overall cross-strait relations have continued to move forward in a constructive manner.

We hope that the countries of East Asia will be able to take the most positive action regarding the situation in the Taiwan Strait by incorporating both sides into the framework for East Asian regional economic cooperation, thereby enabling both to join in the pursuit of regional economic prosperity. Drawing on the region's combined economic power to ensure peace and stability in the Taiwan Strait, and to promote the

joint participation of both sides of the Taiwan Strait in East Asian economic cooperation would be the best way forward for the benefit of all in the region.

Prof. ZHANG Yunling, Director, Institute of Asia-Pacific Studies/ APEC Policy Center, Chinese Academy of Social Sciences (CASS)

Prof Zhang said that the general environment seems more mature than any time in the past for integrated regional economic FTA arrangements. There are many different thoughts. The ideal is for Northeast Asia to conclude the agreement first and then to approach AFTA and put the two regions together. Prof Zhang said of Dr Lee that his timetable of 2010 for conclusion of EAFTA might not be feasible and even then is too late to wait. Prof Zhang felt that perhaps it could be started with the 3 “10+1” and to put on the leaders agenda for 2007 and start the process from 2008. So because the negotiation will be more difficult than any 10+1 agreement, the time frame is very tight.

Regarding the framework of FTA, Prof Zhang felt that the primary concern for each country is different and they can be divided into three groups: advanced economies (e.g. Japan) who are more concerned about the harmonization of the system; emerging economies who are more concerned about market access and security; and less developed economies are more concerned about the benefits of regional economic cooperation.

Commenting on approach, Prof Zhang said that China and Korea started with trade in goods agreement and then negotiations on investment and services. It seems that the latter are more difficult compared to trade in goods. So he said that we had to get some result so we can follow the Japan Korea model otherwise the political momentum will be lost. “We need to think about how to get it started – how to get onto the ‘real’ roadmap”.

Concerning membership Prof Zhang felt the concentration should be on the 10+3 and the East Asia summit as an extension and platform for regional cooperation. Regarding membership of Taiwan, Hong Kong and Macau, there should be no problem but from a practical matter, the Taiwan issue should be handled very patiently and carefully. Taiwan’s membership of APEC and WTO is quite a different background to its membership of East Asia. In the case of WTO and APEC Taiwan’s membership was tied to Taiwan. But in the case of East Asia it started with China alone and without US pressure. It also started from ‘state’ to ‘state’ cooperation rather than from the ‘economies’. Thus Prof Zhang felt the outcome was highly reliant on the Straits’ political settlement. The two sides have already become highly integrated just like East Asia integration. Perhaps Taiwan should not be included from the beginning but if East Asia can make good progress this might cause Taiwan’s to rethink its relations with the mainland. He felt that East Asia’s economic prosperity might be a factor in improving the Straits relations.

Question and Answer / Open Discussion

Dr Lim: I personally think the ASEAN 10+3 would theoretically be more optimum, but the ASEAN 10+1 (three times) seems likely to be the more likely scenario. Regarding memberships, regarding Taiwan, Prof Zhang has commented on the political elements. The margin of preferences in East Asia bilaterals is not far different from the MFA. So as long as these move towards multilateral levels, Taiwan would not be disadvantaged. So Taiwan could join in later on after the political impediments are removed. The same case is what to do with India, Australia and New Zealand. Personally, keep the ASEAN framework for the time being. And then use +1 or +2 further later on without changing the East Asia name if you want to include these countries. By the time that you might need to change the name, the multilateral negotiations might have reached the point where regional or sub regional agreements might not be relevant anyway.

Mr Ong: The current thinking seems to be that ASEAN FTA would be the driving force for East Asia FTA. Does it have to be so? Couldn't Japan or China create the momentum to make the others fall in – I am trying to relieve the burden on ASEAN!

Mr Siew: I would like to draw your attention to the fact that Taiwan's economic connection with mainland China has grown faster than expected. Furthermore as Mr Siew mentioned, amongst China's top 100 exporting companies, Taiwan related companies occupy the first, second and fifth place. China has now replaced USA as Taiwan's number one trading partner. So people in Taiwan want more participation in this region because of this. It also extends to the significant growth in investment and trade links in the region. So Taiwan wants to achieve recognition of its status. Mr Siew also recognized the issues raised by Prof Zhang. Mr Siew commented that there was a growing awareness in Taiwan of the need to foster greater people-to-people relations with China. There has been a changing of the mentality of the people in the last few months.

Dr Lee: Speaking about the sequencing issue. I can agree with Mr Ong about starting with the ASEAN+1 then go to ASEAN+3. However I think we are talking about different things. The ASEAN+1 process is supposed to be finished by 2012. When I said 2015 for ASEAN+3 I think that this is pretty reasonable, maybe ambitious. Start from the feasible ones then maybe we can add other regions or countries such as Taiwan. Other dimensions are trade and investment then we can widen to other areas. We should start from the simpler ones like trade.

Mr Hatakeyama: Regarding three ASEAN+1 approach would be more desirable than having the ASEAN+3 stage. Then if ASEAN+1 is completed why don't we jump into East Asia FTA building? This would relieve the burden on ASEAN.

Regarding the custom union as Dr Lee mentioned. Singapore does not have too many tariffs. So if custom union is forced upon Singapore, for example, it would have to pay compensation – so this step too should be skipped.

Regarding the membership of Taiwan and Australia, New Zealand and India. Average internal export dependency ratio of East Asian countries is 63% whilst India is only 23%, New Zealand 27%, even Australia 49%. There is quite a difference between these two groups. Whereas Taiwan has 58% export dependency, so it would only be natural for us to try to include Taiwan. I am optimistic that it could be included from the first place but at least the consensus that it will be admitted in the future. I would like to confirm on this opportunity.

Research Presentation “EAFTA and CLMV”

Moderator:

Mr. Vincent C. SIEW, Chairman, Chung-Hua Institution for Economic Research (CIER)

(Former Premier of Taiwan Republic of China)

A major challenge to regional economic integration is how to balance the interests of countries and territories within the region that are at different levels of development. Take European economic integration for example. The countries of Europe were all deeply aware at the beginning that disparities in their economic and social stature would be a very serious issues affecting integration. Therefore, starting with the Coal and Steel Community in the 1950s, they sought to deal with this issue on the institutional policy side, employing structural funds and social policy coordination as the two main policy tools for minimizing the impact of regional integration on countries and territories at different levels of development.

Moreover, when the EU member countries passed the Treaty of Amsterdam in 1997, one of its key aspects was recognition of the differences among member countries in terms of their economic and social development, and the need for flexible treatment tailored to each country’s differing situation.

Among the member countries of ASEAN, the four so-called “CLMV” countries (Cambodia, Myanmar, Laos and Vietnam) lag behind the other six in development. How to employ common policies or other institutional adjustments or tools to coordinate the interests of these four countries and those of the other members, and how to help the four to develop and grow, not only will affect the future prospect of ASEAN, but also will have an important relevance to the success or failure of EAFTA.

Today, Dr. Hank Lim, Director of Research of the Singapore Institute of International Affairs, will expand on this. He will also tell us what kind of role the three countries of Northeast Asia should play to contribute toward the successful development and growth of the CLMV countries.

Presenter:

Dr. Hank LIM, Director of Research, Singapore Institute of International Affairs (SIIA)

Dr Lim starts by saying this is the second research project commissioned by JEF and thanks them. The first was An Integrated Roadmap for EAFTA presented in Manila in February 2005. He tells the audience they have the executive summary as the full report is 65 pages.

In regard to economic integration in RTA, it's important to have "clear, predictable and transparent objectives." Modalities and mechanisms are important. The timetable for achieving RTAs must be clear. "Monitoring, sequencing and implementation are all involved." The choice of modality is very important to fit the CLMV into EAFTAs.

A single market and production base is not theoretically or economically correct, because the AEC is not intended as a single market and production base. These bases are much more comprehensive than economic communities. Free flow of goods, services, investment and skilled labour and a freer flow of capital is different to what's intended in an AEC. So far the framework is based on "resource pooling" ie sharing the market. ASEAN hasn't achieved much in "beyond border measures." This is despite it signing ASEAN Framework Agreement on Services (AFAS) and ASEAN Investment Area (AIA). Investment is critical for ASEAN and East Asia.

All the details on page 4 are in the document.

On page 5, the Vientiane Action Programme is broad but lacks details, except for focus on 11 priority sectors. All these 11 sectors chosen are logical. But additional sectors to be added progressively as institutional capacity of ASEAN increases, is not the modality for creating an Economic Community.

Enhancing competitiveness for economic growth and development through closer economic cooperation. ASEAN is achieving a broadening but not a deepening of economic growth and development, especially the CLMV. VAP encourages accelerating the integration process towards a single market and production base, but VAP does not address many basic issues and elements.

What is the AEC? In my opinion, it's just AFTA+ and conceptually a sub-set of the proposed EAFTA, more than an economic community. This is because of the "reluctance of members to concede part of their sovereignty for the agreed community."

What is the weakness of VAP:

- Lack of clarification of nature of AEC
- It's not enough to merely strengthen existing cooperative efforts among ASEAN
- Institutional arrangements for monitoring needed and a dispute mechanism needed, as pointed out by Mr Ong

We need to intensify the appropriate implementation schedule, create new institutional frameworks and build up human resource capacity.

Regarding the AEC and EAFTA and implications on CLMV:

- EAFTA likely to be more beneficial for CLMV economies because:
- Larger economic size of EAFTA as pointed out by Prof Zhang
- Ability of the more developed Northeast Asian countries to provide financial and technical assistance to CLMV
- Real or net impact of either AEC or EAFTA will depend largely on the structure and manner in which assistance is provided
- Vietnam and Cambodia likely to benefit more than Laos and Myanmar in both AEC and EAFTA because Laos is landlocked and doesn't have manufacturing. In Myanmar it's due to political situation and isolation, ie non economic factors.
- More comprehensive and sustainable reforms by Cambodia and Vietnam, evident in Cambodia's accession to the WTO in Oct 2004 and Vietnam's accession to the WTO member possibly by the end of 2005. So you have more consistent reforms and multilateral pressure on Cambodia and Vietnam.

With globalisation and regionalisation in East Asia, the development gap would widen and reduce the absolute value.

To mitigate widening gap, CLMV should adopt the measures printed on page 13. "I won't read it to save time, but there is a great deal of responsibility required by the CLMV countries."

Border trade between Cambodia, Vietnam, Thailand and China is more relevant and practical than the AEC or EAFTA.

The likely extent of financial and technical assistance is dependent on their respective national self interests and level of development. Based on our study of the research project:

- China has the strongest vested interest to assist the CLMV due to its geographical proximity.
- Japan is the most developed and technically advanced Asian country
- South Korea, with increased growth has the increased likelihood of importance as an aid donor.

"These are the main findings from our research."

Commentator:

**Mr. HO Quang Trung, Deputy Director General, Import-Export Administration
Department, Ministry of Trade-Vietnam**

“The presentation made by Dr Lim has given us a broad panorama of what economic benefits from AEC and EAFTA can be expected for countries in the region, particularly for lesser developing countries like Cambodia, Lao PDR, Myanmar and Vietnam. However, it should be noted that the reallocation of resources to more productive uses in an RTA, usually involves some adjustment costs, including the displacement of employment across industries within the countries.

In the CLMV, there is a growing concern that, as their economies are fully liberalized in accordance with their RTA guidelines, their respective industries will not be sufficiently prepared to face the forces of regional competition and thus unable to take advantage of the economic opportunities provided by RTA. Much of this concern is related to their infant industries including agricultural products and other processed foods, which they think will face greater competition from their more developed neighbors in the RTA.

Another source of concern for the CLMV countries in the process of tariff liberalization is the anticipated reduction in their tariff revenues, as they are particularly highly dependent on international trade for their source of government revenue. For example, the share of import tariffs in total revenue in 2001 ranged between 7% to 25% in CLMV. In EAFTA, extensive trade liberalization imposes heavy and perhaps unacceptable adjustment costs on the lesser developed economies like CLMV and these economies would require a much longer time frame to liberalize and to receive massive development assistance for capacity building to compete. For example, in the proposed EAFTA, the challenges for CLMV may be greater in a short-run as they may face wider trade deficit. Statistics in the presentation made by Dr. Lim have shown that CLMV have had continuous big trade deficits from China and Korea from 2000 to 2003.

In their commitments for tariff reduction in EAFTA as it may require, this deficit is likely to be a greater problem for these countries. In recent years, CLMV have rapidly developed their export capabilities, but the structure of their major exports has not changed substantially. Export revenues cannot compensate for the more import of intermediate and capital goods from China, Korea and Japan for their own industrialization when the tariff is expected to be cut down in the proposed EAFTA. High protection of “sensitive” agricultural products from more developed countries in Asia makes CLMV much difficult in raising their export incomes. However, as Dr Lim has pointed out, in East Asia, there is much more benefit for the CLMV.

The trade pattern is no longer simply one-way trade based on international differences in resource endowments. Rather, sophisticated vertical production chains as well as distribution connection are extended to region-wide networks. If CLMV can seize the opportunity of their substantially low wage levels and abundant natural resources and are able to be successful in attracting labour-intensive production processes, these countries can be fully involved with the regional production and distribution networks.

So it is important that the less developed ASEAN countries (CLMV) should not lose out from deeper and wider regional integration. By leveraging on their cost advantage in the production value chain, the CLMV countries would clearly stand to benefit from being part of a regional production base. However, they have to achieve a minimum threshold level of economic and social development to participate effectively in both the regional integration and globalization processes. They need the capacities—in terms of infrastructure, technology, and human resource development—to maintain a competitive business environment and economic and social stability in order to capitalize on the benefits of liberalization. This would include financial and technical assistance, transfer of technology, education and training facilities.

The ASEAN-6 have initiated their development assistance and temporary preferential treatment, as mentioned by Dr Lim, to CLMV with the implementation of the ASEAN Integration System of Preferences (AISP) and the establishment of an ASEAN Development Fund.. So ASEAN's efforts to accelerate the integration of its newer members into the regional market for trade in goods and contributed to the narrowing of the economic divide among ASEAN members.

However ASEAN might be financially constrained to help the CLMV countries in a significant way. This is why the East Asia Community might be more viable. In his presentation, Dr Lim has pointed out more benefits for CLMV in EAFTA due to the larger economic size of EAFTA and the greater ability of the more developed Northeast Asian countries to provide financial and technical assistance to CLMV. How much benefit can CLMV derive from EAFTA depends on the level of participation of more developed countries to assist less developed countries in the region. With the ongoing economic reforms and liberalization in trade and investment in CLMV, these countries would be able to take advantage of more trade facilitation and investment flows from China, Japan and Korea, thus being faster integrated with other economies in East Asia."

Mr Siew adds that Taiwan is also very active in this area. "We have invested heavily in Vietnam and Cambodia and hope we can continue partnerships with this region."

Mr. Hiroshi TSUKAMOTO, President, Japan External Trade Organization (JETRO)

Mr Tsukamoto starts by saying he enjoyed Dr Lim's presentation on closing the gap between the CLMV and ASEAN. But at the same time, closing the gap between ASEAN's top six countries and China, Korea and Japan is also very important.

Recently JETRO launched 10 Recommendations for the Comprehensive Economic Partnership (CEP) between ASEAN and Japan. This is on page 71 of the booklet so he asks the audience to refer to it. This is the answer to what Japan can do to close the gap between ASEAN as a whole. He goes on to say that in his presentation, he will focus on the CLMV.

On page 72, he outlines the first step in JETRO's project, "(1) Enhancing the industrial competitiveness of ASEAN through partnerships with Japanese firms, especially in developing strategic sectors." He exemplifies this in the automotive and electronics industries. He says Japan would like to "cultivate competitiveness of the ASEAN auto and electronics parts industries." He adds that Thailand's automobile industry is very prosperous. In the case of Toyota Hilux, they are now enjoying 95% local procurement, but in the case of Honda, it is 72% for Civic. These procurement ratios have room for improvement.

On page 73, Supporting ASEAN's Efforts to Narrow Intra-regional Disparities by supporting Laos in developing the country's silk product brand "Chai Lao." This means "Heart of Laos." The Lao silk industry has great export potential and therefore Japan can assist in the promotion of international business activities. In the case of Cambodia, in 1999, JICA established the Cambodian Government Training Centre with a 1000 graduates to date in the Cambodian textile industry. It can also assist in supporting and reinforcing functions of the Secretariat of the Greater Mekong Sub-region (GMS) Business Forum. A federation of chambers has been established. Investment promotion is very important. We are organizing for Myanmar in Bangkok this year an investment promotion campaign for Japanese companies. Facilitating Logistics Services is also very important.

He then asks participants to look at page 76. Dr Lim has mentioned the importance of border trade and now emerging transportation is happening from Bangkok to China. Very recently on the border of Vietnam and China a huge exhibition of more than 200 companies were attracted by land transportation. Customs clearance needs to be developed.

He directs the audience back to page 73, where he will skip Environment and Energy Conservation but this is also important. He also skips Point 5 on the Rules of Origin because the next session will talk about this. Establishing Transparent, Simple and Harmonized Customs Clearance Procedures is point 6.

Eliminating Non-tariff Barriers and Mutual Recognition of Standards and Conformance is point 7. He exemplifies a recent Malaysian non-tariff barrier. The Government guideline was that if a manufacturing company wants to set up a domestic sales company they had to set up another company. These are the kinds of issues, which need to be discussed for the sake of business.

Point 8 Improving Protection of Intellectual Property Rights (IPR) is very important.

Point 9 is Improving Business Environments as a whole.

Strengthening Business Relationship between ASEAN and Japan is point 10. Especially as Dr Lim has said the efforts by Japan, China, Korea and Taiwan are very important.

Finally Mr Tsukamoto gives an advertisement shown on page 77. This Mekong Exhibition in Tokyo aims to encourage the CLMV to come to Japan for business opportunities.

Question and Answer / Open Discussion

Mr Hatakeyama seeks clarification from Dr Lim. He says Dr Lim said “Japan is going to announce a big package at the East Asia Summit meeting to help the CLMV.” Mr Hatakeyama says this is not what he has heard and asks for this sentence to be deleted. “In this context, you mentioned the importance of EAFTA rather than the ASEAN EC.” Japan can provide more ODA with these countries, but it is not binding. The market for EAFTA is much bigger than the AEC. Therefore EAFTA will be much more conducive to development of the CLMV, but not otherwise. He adds “I don’t agree with the analysis.’

Dr Lim starts by saying the two panelists brought up some interesting points. He agrees with the main elements discussed by them. He has read the JETRO reports. Maybe these will be discussed at the ASEAN + 3 Summit instead of the East Asian Summit. He says JETRO has very specific recommendations. He was involved in the ASEAN India Vision 2020. They had very detailed programs to help the CLMV.

In regard to ODA, EAFTA will somehow substitute for ODA. “Market forces will come into play to reorganize the CLMV market structures.” ODAs will continue on a bilateral basis. There is no market impetus in the CLMV so no regeneration. It’s conceptually better than ODA. Synergies must be created between EAFTA and CLMV. It’s an improvement from past initiatives, such as the Asian Development Bank, which wasn’t so successful, because domestic capacities were not present or on a sustained basis.

The second question is posed by Mr Ong. He adds one or two pointers about JETRO’s ten recommendations. They were formally received in Jakarta and the process is to send them to senior economic officials who will examine them and either implement or work with JETRO or send it to the economic ministers at ASEAN + 3. He thanks JETRO and says the recommendations are being steered through the system in ASEAN. “Many of the recommendations are things the Secretariat wants to do anyway.” He hopes the bureaucrats will cooperate.

Regarding ODA, in the development of the CLMV, the “major part is capacity building.” Much of this depends on Japan, Korea and China. Japan especially has been the main protagonist, but in the last three years, Korea has helped a lot more. China is being encouraged to “do more.” Many people don’t realize the amount of work done by

these donor countries. He doesn't see the readiness of the CLMV to do business with the global market. They have to be regulated or equipped to deal with the Mekong market area, "let alone the global market." Therefore the capacity building and external assistance given by Japan is instrumental in this. Lastly he refers to the focus by Dr Lim on VAP. He says this is meant to "be a guide for ASEAN countries, basic and generic." The last part of VAP focuses on helping the CLMV countries close the development gap. Therefore there is not as much focus in VAP on the other six ASEAN countries.

In response, Dr Lim agrees that VAP is a "blueprint, which must be followed by a more detailed roadmap or follow up policies." So far only eleven priority sectors are supported by a high level task force. "I don't intend to criticize VAP but it must be followed by policy details on how to implement it. On the ASEAN integrated roadmap for closing the gaps, the recipient countries represent a small 5%. Receptive countries clearly haven't articulated their needs, and donor countries of ASEAN haven't been as open or willing as Japan, Korea and China.

Mr Tsukamoto then says he agrees with Mr Hatakeyama's stance that ODAs help, but "self sustainability of the recipient countries is very important." He says that Japan is encouraged by the recent initiative by the Vietnamese Government to have a shop of Vietnamese craft in Tokyo. In Thailand, the Pakistan Government is interested as a result of a successful exhibition. "Therefore cooperation is important."

Session 4: The relation between bilateral or regional FTAs in the region and a possible EAFTA

Moderator:

Dr. Djisman SIMANDJUNTAK, Chairman, Board of Trustees, Department of Economics, Center for Strategic and International Studies (CSIS-Jakarta)

"For an FTA to be of substantial impact nowadays, it will have to be deep in nature given the progress made in trade multilateral negotiations as well as progress made in unilateral liberalisation." The margin of preference of FTAs is now much thinner than in earlier decades. We must avoid administrative requirements that result in high cost. One of these is "rules of origin".

We already have some rules of origin in place. So how can we harmonise the existing rules? This will be an important topic.

Presenter:

Prof. Norio KOMURO, Professor, Graduate School of Law, Kobe University-Japan

Prof Komuro started by saying that rules of origin (ROO) are a very complicated matter and that no-one would willingly undertake to study this topic. There are two problems he addressed: (i) whether to harmonize Asia-Oceania FTAs rules of origin and (ii) how to draft the EAFTA rules of origin.

Regarding the first question, the answer is clear and that is the answer is 'yes' harmonization is desirable. If not, it will frustrate companies and will be very costly.

This is shown by the experience in the EC in concluding the Pan-European rules of rules of origin (PERO). The EC Commission advocated the uniform ROO. And now the EC is now extending PERO to other partner countries.

On the second point there are 4 major issues:

- (i) basic ROO approach
- (ii) origin criteria
- (iii) cumulation test
- (iv) certification and verification.

Regarding (i) there are currently two rules. One is uniform FTA ROO for all products that is adopted by ASEAN. ASEAN applies the 40% value added test to any items. NAFTA, PERO and other bilateral FTA use this product specific ROO. So this approach is desirable. In a large FTA like EAFTA product specific, which allows for the sensitivity between different products and different areas is desirable.

Origin criteria. What criteria are adequate for the EAFTA? There are currently three types: the change in tariff classification test; the value added test; and the processing test. The first only looks at the HS number of the final product and the HS of non-originating materials. This is a very user friendly and that is why a number of countries have changed their test from value added test to this tariff classification test.

The problem with using a value added test in the territory of the EAFTA is that it is very difficult to calculate. In ASEAN there are two methodologies, the indirect and the direct and the denominator is the FOB price. In other FTA there are other methodologies for value added for example in NAFTA, they use the net cost method. But this notorious net cost method is very costly in the case of automobile manufacturers. In the US-FTA negotiations Australia agreed with the US that the net cost methodology should apply to cars and car parts. This of course is a question of politics. But we should avoid such a methodology, even though it is advocated by Japanese manufacturers operating in the US. In PERO they apply a different value added test based on ex-factory price. But this price does not exist. But companies do not use this price so it must be calculated and thus is very burdensome. The last methodology is the build up and build down test drafted by the US. It persuaded Chile in accepting such a method. In this they only look at the originating material cost. This is difficult to calculate.

In Prof Komuro's opinion the best method to be used is the one based on actual costs - not calculated costs - and the denominator is FOB price and the deduction methodology should be applied. The sum obtained by deduction non-originating materials from the FOB price of the final product. This method is desirable for EAFTA.

On the question of processing test, during the negotiations of WTO etc, some specified processing is designated as that which confers origin and so this methodology is not good as it deters technical progress.

Therefore we look now only at the tariff classification test and the value added test.

Which is better?

This is a difficult question. The value added test is advocated by the EC and ASEAN.

But there are some tendencies to change the methodology to tariff classification.

The third issue is related to cumulation test. This will have to be settled politically in the discussions of the EAFTA.

Regarding the certification system, there are four types: self certification those done by private parties; public certification by customs or other authorities; approved exporters adopted under PERO; Chamber of Commerce certification adopted by Japan in negotiating FTAs with other countries. Which is the best system?

How about verification? Exporters' authorities verification or importing countries customs official, by visiting the premises in the exporting country. This is also an important political issue.

Commentator:

**Mr. HO Quang Trung, Deputy Director General, Import-Export Administration
Department, Ministry of Trade-Vietnam**

Within the AFTA framework, the rules of origin have been considered liberal, compared with the rules used in agreements of the EU and NAFTA. The 40% ASEAN content requirement is the general principle applied to all products eligible for tariff reduction under theCEPT Scheme, meaning that there are no complex product by product rules of origin.

The Task Force on theCEPT Rules of Origin is currently working on the practical implementation of an alternative criterion in determining origin. The so called "CTC (Change in Tariff Classifications) rule" will become applicable to products which cannot fulfill the 40% local/ASEAN content requirement. The introduction of the alternative "substantial transformation rule" might render theCEPT rules of origin more

flexible, especially for the poorer member states, where producers in certain sectors have difficulties to comply with the 40% value added requirement.

In ASEAN-China FTA, the ROO uses the method and application almost the same as that of AFTA with one basic method of RVC of 40%. The ongoing negotiations of ROO in ACFTA specify some products, which use CTC as a criterion for origin determination.

However, the recent bilateral agreements concluded by individual ASEAN members with external trading partners tend to follow the administrative models of these external partners, thus leading to more restrictive rules of origin. The ROO in Japan- Singapore EPA (JSEPA) applied change of tariff heading test (CTC) for most of the products. However, the value added test (VA) is up to 60% (with a combination of subheading changes) for other chapters. The manufacturing and processing operations are applied for textile fabrics and articles (HS59). The combination of the different criteria makes the ROO more complex and stringent, especially the combination of CTC and VA. Normally, this type of ROO is introduced for sensitive items like in FTAs by Japan and Korea. These stringency and complexity may cause an increase in costs for production and trade.

So it is a must that every country in the region should take an active role in the work of harmonizing rules of origin in the proposed EAFTA to ensure that the resulting harmonized regulations should facilitate trade liberalization and reflect ongoing trends in the regionalization of production.

It is right to say that preferential origin criteria must be stricter than non-preferential origin ones in order to prevent any “free-riders” of the preferences as an FTA aims at liberalizing trade between its partner countries and thereby promoting the regional industry. However, it should also reflect the industry’s capacity and economic reality in the region. Up to now, low utilization rate of CEPT concessions in AFTA has somehow reflected the low level of economic development in some member countries, making them unable to achieve the 40% local content requirements. Yet the current ASEAN 40 percent value-added test is still considered to be less strict than harmonized non-preferential rules of origin. If rules of origin in EAFTA are to be made stricter than the present ones in AFTA-CEPT, most of enterprises in lesser developed countries like CLMV in the region may find it unachievable to comply with the ROO requirements, thus possibly being “an outsider in the game”.

The diversity in economic systems and economic development levels in East Asia would make it difficult to draft the EAFTA rules of origin due longer negotiations to reach consensus in ROO harmonization. One of the key issues is selection of the origin regime applicable and acceptable for all parties concerned. The basic principles, as Prof Komuro has pointed out, must be costless, easy-to-administer and user-friendly. It should invite more investments in the region on the one hand and prevent anti-circumvention on the other hand. It can be stringent, but it must accommodate the economic reality of the less developed countries in the region. Otherwise, these countries would be unable to benefit from this regional trade arrangement.

The EAFTA origin regimes should be adopted on the basis of the degree to which they promote intra-regional industrial cooperation and reinforce the competitiveness of East Asian industries. The determination of whether full or partial cumulation is preferable for East Asian integration is a critical element of this determination. As a majority of East Asian countries are developing countries, compromise and open negotiations between developed countries and developing countries are inevitable in order to reach harmonized rules of origin in the creation of the East Asia Free Trade Area.

H.E. Mr. ONG Keng Yong, Secretary-General, Association of Southeast Asian Nations (ASEAN)

Mr Ong made 5 points.

1. it is not possible to harmonise the existing ROO in all the FTAs that ASEAN is engaged in.
2. so we are thinking to draft a new ROO that apply to all the parties in East Asia.
3. four principles must be used, these are:
 - a. ROO should be simple yet precise
 - b. Transparent
 - c. Designed so that it does not distort trade or be used as a non-tariff barrier
 - d. Must be applicable over all regions and products

Mr Ong said that it sounds simple but that his colleagues in the Secretariat said it would be almost impossible to achieve.

4. encourage the WTO to devise a new ROO
5. what is the purpose of ROO? Is it to prevent a non-party from using the ROO to get advantage from any trade transaction? When one looks at the countries coming together in an EAFTA they are very substantial, then perhaps there is no need to worry about the companies using various countries to circumvent ROO etc, we should start from scratch and design a new ROO along the four principles mentioned above.

The existing ROO were a product of a different era. It is not possible to harmonise them. When ASEAN chose the 40% value added criteria in 1990-91, this was chosen from the viewpoint of simplicity. But subsequently, Japan's substantial investment in ASEAN countries and regional production, meant that the system became very complicated. We do not want to have a very complicated system and "big thick book" of rules. This will be a big burden and costly to small companies. Mr Ong quoted the case of a small dried fish company where an investigation showed that for every \$100 of exports they have to spend \$3 (3%) on ROO paperwork.

Mr Ong said the solution for the EAFTA was, as he was proposing that EAFTA countries should develop and dictate a new ROO to the rest of the world.

Mr. Jae Ho PARK, Director, Fair Trade Division, Korea Customs Service

Mr Park said the purpose of an FTA is to confer a benefit to exporters. That means if the burden of paperwork caused by an FTA is greater than the benefit of the abolishment or reduction of tariffs then exporters will give up support for the FTA. So some exporters complain that it costs as much as 5 or 6% to comply with the rules of origin.

So the ROO is not the target, it is merely a tool for the creation of trade between FTA members. Sometimes the volume of supporting evidence is more than that of the certificate of origin itself. Such phenomena should be eliminated or reduced.

Regarding the issue of harmonization for EAFTA, Mr Park thinks it is possible. He compared and analysed for this forum, the preferential rules for China Korea and Japan. He found many commonsense. The basic ROO principle for the three countries was change of tariff classification. (CTH rule). That is an important point for the future because there is a common basis.

Concerning issuance of certificate of origin. It is a little different between the countries? This was a headache for Korea and ASEAN. After long discussion a moderate position was adopted. So Mr Park thinks compromise is possible.

On the question of the main criteria for origin determination, Mr Park said, that the main difference that in ASEAN the basic criteria is the 40% value added rule whereas for Japan, China and Korea, it is the CTH rule. There are big differences but I think it can be overcome through extended discussion.

Regarding the modality of EAFTA. Personally, Mr Park advocated the on-going WTO non-preferential ROO, which started in 1995. Whilst it is still under process, the completion is expected at the end of this year.

So making harmonized ROO for EAFTA is possible.

Question and Answer / Open Discussion

Dr Lim: Probably the ROO is behind the times. You know because of borderless globalisation and production networking hardly any product is produced in one country. Harmonisation is favoured by the developed countries. Why not make it in stages? More important is the Mutually Recognised Agreements (MRA), customs clearance, standardization of customs procedures etc. So it may be possible to defer the harmonization, difficult as it is, to a later stage. Hopefully the multilateral negotiations and production networking will make such issues outdated.

(unknown questioner): What is the future image of ROO?

Prof Komuro: The issue of harmonization is the most important issue. The other is whether it is feasible to establish an EAFTA. This question has been addressed by the EC and issued in a Green Paper on ideal ROO in an FTA. In that paper the European Commission concluded that harmonization of FTA ROO for partner countries and surrounding countries is the best way and this methodology has been adopted by the European Commission since 1995. But in EAFTA the situation is totally different because there is a lot of discrepancies between the ASEAN 40% value added test for all items and product specific ROO based on CTC in other countries.

There is some tendency to change the thinking. This was evidenced in the case of Australia in its FTA with New Zealand, which used a 50% value added rule (like the ASEAN 40% rule), but found it has not worked and they are now favouring the use of CTC.

ASEAN whilst applying the 40% value added test, have modified their thinking and in 4 areas, flowers, forestry products, steel and aluminium they are now applying the CTH test. So nothing is unchangeable.

Mr Ong: ASEAN has given the option to exporters in four areas to use the CTC basis. As mentioned previously, the 40% value added test was developed in the 1990s and this was the most convenient method for ROO. So as the marketplace changed, more and more exporters wanted to follow the CTC test. But presently there is one complication. In the CLMV countries they have just converted everything to value added. But I understand that if this is necessary they are prepared to change, but they have asked that it would be confusing as the customs officials have just completed training in value added. So the ASEAN secretariat is proposing that all three methods (value added, CTC or specific processing) can be used selected by the exporter. So we start thinking how to get ROO, it does not mean we forget about harmonization rather than making do with the existing pieces we have.

If we want to develop an EAFTA we need to develop a ROO otherwise we will lose our comparative advantage. Mr Ong instanced the case of the loss of comparative advantage in electronics to Latin American countries and East Europe.

Prof Komuro: We should not forget the cumulation test. This is very useful for less developed countries. Prof Komuro commented on the cumulation test in relation to carded cotton exported from China to Australia and then exported to the US under the US-Australia rules. He instanced three kinds of cumulation.

Dr Simandjuntak: Can you imagine where Japan would have to apply a different ROO to each of its different trade agreements – it would be a nightmare. Some 65% of imports in East Asia have tariffs of only 5% or less, so complex ROO for these are not justified for the cost. On the other hand there are a few products where more stringent ROO are needed where the tariffs are high such as agricultural products, base metals, textiles and apparel. Common ROO are needed with the least cost.

(Another comment from the floor) Processing issues cannot be separated from FTA ROOs. It is related to the purpose of FTAs, which are (i) creating a 'free ride' and (ii) creating investment. There is no 'draw back' rule in ASEAN but there is in Europe. A product example is then given where a German product uses some Japanese components. This has implications for the tariff applied to this product. For example it would be zero if the product were considered to be made in Germany. If the EC common tariff were applied to Japanese components, i.e. 5%, it does not promote or provide incentives for German companies.

Dr Simandjuntak: This one example shows how difficult it is to deal with reverse ROO.

Closing Remarks by Mr. Noboru HATAKEYAMA, Chairman and CEO, Japan Economic Foundation (JEF)

Mr Hatakeyama said he was very interested in Dr Supachai's speech about the point of the necessity for 'synergy' between FTA and WTO. Regarding individual countries' FTA as of now, Mr Hatakeyama was impressed by some comments regarding the necessity of reviving Japan-Korea FTA. Whilst the environment may not be conducive at the moment, such comments were encouraging, not just for Japan and Korea but also for the rest of Asian countries.

Regarding creating EAFTA, timing was discussed, and there was no opposition to completing EAFTA by 2020 although we were not too confident on this. On the question what is ASEAN Economic community, we found out that it is not a so-called community, but something like AFTA+ or ASEAN EPA+, which is meaningful and interesting. If ASEAN takes the leadership in creating EAFTA, then ASEAN will play a great role in creating East Asia community as well. In that case, the concept of community may be something like EAFTA+ or East Asia EPA+ not the community requiring the concession of their sovereignties to that body. The question is what kind of work could be allocated for the East Asia Community.

Regarding CLMV, we agreed that market is more important than assistance. To narrow the gap not only between CLMV and ASEAN countries, but also between ASEAN and other developed countries will be important.

On the question on ROO, we learned a lot and "the devil is in the detail".