

DRAFT

Asian FTAs in Progress - An introduction to EAFTA, CEPEA and TPP

Gary Hawke

Emeritus Professor, Victoria University of Wellington &
Senior Fellow, NZ Institute of Economic Research

Under Economic Crises, how Asia should and could promote further economic integration
JEF and RIS International symposium,
Delhi 23-25 September 2009

1. Context

We are asked to ensure that “discussions are not too generalized or abstract”. Nevertheless, I want to put EAFTA, CEPEA and TPP into a wide context.

The pattern of Asian FTAs is well summarised in ADB research.¹ It provides the evidence which establishes:

1. FTAs in Asia have grown at an accelerating rate. This can be attributed to deepening market-driven integration and the formation of East Asian production networks and supply chains, European and North American integration and anxiety about blocs, the 1997-98 Asian financial crisis which showed a need to address common challenges, and slow progress in Doha.
2. The resulting pattern is one of hubs and spokes, the hubs being the region’s five largest economies, Singapore, Japan, PRC, India and Korea. This coexists with a widespread acceptance that ASEAN should have a central role in the regional architecture.
3. Asian FTAs tend to cover a large fraction of trade, but a smaller fraction of trade lines is covered, the consequence of excluding agricultural items. Although 50% of FTAs cover at least 85% of agricultural product lines, 24% have no coverage or less than 100 product lines covered, and 26% are in an intermediate position. Furthermore, the product lines excluded are not selected randomly but those which have large protective effects.
4. More of ASEAN’s trade is with FTA partners than is true of major economies but trade with FTA partners does not necessarily imply that the FTA is being utilized.

The same paper identifies as major challenges:

1. improving firm-level use of FTAs,
2. the noodle bowl (although firms see few problems and SMEs are less bothered than large firms),
3. promoting comprehensive coverage of agriculture,
4. increasing WTO-plus elements, and
5. forming a region-wide FTA.

The last is our specific concern. Rather than seeing it as one of a number of challenges, I want to treat it as a means of addressing the preceding challenges.

However, I first want to become a little more abstract. One of the factors identified as a cause of the growth of FTAs is the slow progress of the Doha Round. There has been a lot of discussion of Plan B, and some would have written about “competitive liberalization” rather than apprehension about being left behind by integration in Europe and North America. I think it important to

¹ Most recently, Masahiro Kawai and Ganeshan Wignaraja “Asian FTAs: trends and Challenges” *ADB Working Paper Series* No 144 (August 2009)

recognize the rather simpler points that the agenda of economic integration has got vastly more complex and that the number of players has increased markedly over time. The early GATT rounds had a little over 20 participants, more or less the size of APEC now and negotiators and negotiations could be accommodated in a few modest hotels. Now about 200 delegations are involved. Despite the limited acceptance of even such “Singapore” issues as investment, services, facilitation, and government procurement, the Doha Round has encompassed new complexities in environmental goods and services, “green, blue and amber” categories of subsidies, and special and sensitive products, so that the agenda is even more complex than that of the Uruguay Round even before we consider different interpretations of “development”. Furthermore, negotiators in the early rounds were more or less isolated in an individual setting and charged with reaching an agreement. Nowadays, negotiators are closely tied by modern communications to multiple agencies and interests in national capitals.

Gatt Rounds

Rounds		
1947	Geneva	tariffs
1949	Annecy	tariffs
1951	Torquay	tariffs
1956	Geneva	tariffs
1960-61	Geneva (Dillon Round)	tariffs
1964-67	Geneva (Kennedy Round)	tariffs and anti-dumping measures
1973-79	Geneva (Tokyo Round)	tariffs, non-tariff measures, “framework agreements
1986-94	Geneva (Uruguay Round)	tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc

Economist 3 October 1998, “World Trade Survey”

This is all well-known, but the implications are more profound than often realized.

First, it is no longer simply convenient but grossly misleading to focus attention on market access for goods. The temptation is difficult to resist because data is most available for trade in goods, negotiators are comfortable at trying to find a mutually-acceptable trading of concessional entry, lobbyists can formulate their interests most easily on preferential access for goods trade, and politicians are used to managing conflicting pressures from officials and lobbyists and most of it seems to come from bargaining about tariffs. The changed terminology to “economic integration” is important. Whereas APEC grew with the trilogy, liberalization, facilitation, and economic and technical co-operation - and the framework can be found with only a little modification in CEPEA, the better guide would be the current APEC terminology of “Leaders’ Agenda for Implementing Structural Reform”. The fundamental issue is determining the criteria on which business can be conducted across boundaries and for governments that translates into aligning regulatory structures and processes with cross-border economic drivers. The notion of “increasing WTO-plus elements” is not adding a few items to the main business; it recognises the changed agenda of international economic diplomacy.

CGE modelling is useful. It established the general proposition that aggregate gains are almost always greater when an FTA has more members. It also provides information on what sectors will face the biggest challenges in identifying an adjustment path as trade in goods is liberalized. But although data availability directs attention to trade in goods, that is not a justification for overlooking the changed nature of economic integration. The most useful exercises in CGE

modelling are those which seek to address services and investment and even further elements of integration, in which Shujiro Urata has been prominent. This is where research effort and funding should be concentrated.

Because FTAs are not restricted to market access, their attractiveness and effect cannot be assessed by how firms respond to surveys which are treated as enquiries about the use of preferential market access provisions.² The usual argument is that FTAs are not well-known nor well utilized. The result that FTAs are used more by large firms than small is attributed to onerous administrative requirements - small and medium enterprises are, in effect, excluded - and the result that the “noodle bowl” is more problematic to large than to small and medium enterprises, which some find surprising, is explained by large firms having more markets. (In effect, SMEs “shop” among agreements and markets and choose those which they utilize. Rules of origin might nevertheless be preventing achievement of the optimal outcome, especially over time.) These arguments are plausible, but we should not be content with exclusive attention to tariffs. (It is reassuring that firms like the idea that rules of origin should allow them to choose between change of tariff classification or value content, but hard to think why they would not favour choice.) Firms may not see the value of FTAs if they look merely at preferential border access. The more general ability to do business across borders is less obvious, especially to managers at an operational level. (We might wonder about the impact of rules of origin on terms of an FTA other than market access, but in practice they seem to be of little significance. It is firms which deal with regulators, not their precise products.)

Secondly, the dynamics which the WTO inherited from GATT were that the key was agreement between the US and EU, generalised by the “single agreement” in which all members agreed to the consensus. The process involved masses of specific agreements, which permitted recognition of what might be called idiosyncrasies such as the importance of Iceland to fishing negotiations or the role of New Zealand in agricultural negotiations, but the core process was reconciling the interests of the US and EU. The number of significant players has changed, and that is sufficient for the basic dynamic to be altered. But at the same time, the agenda has widened and the gap between the interests, at least their perceived interests, has widened even more.

The reason for the growth in FTAs given earlier should probably be amended. Rather than focus on slow progress in Doha, we might speculate that we will not see “rounds” of a traditional kind in future. Rather we will see agreements in smaller groups and on more confined agendas.

Such a change should not be accepted without careful consideration. The most favoured nation clause, with the consequence of generalizing concessions to any member of the club to all members has been a cornerstone of the multilateral system for the last 60 years. Furthermore, it has been the “single act” by which a decision is taken by consensus at the conclusion of a “round” which has generated momentum for finding a package which enables all to acquiesce. A world without these features is a very different world.

There is already a range of agreements which govern economic interdependence. Much trade, for example, is covered by the Information Technology Agreement and not by any of the usually-recognised FTAs. There would be more if current moves towards special arrangements for “environmental goods and services” bear fruit. The category is very unspecific and an open invitation to rent-seeking and we might hope that the efforts are unsuccessful. It is unwise to divert resources to carving out new categories of goods when the agenda is widening in more

² cf. Daisuke Hiratsuka, Hitoshi Sata, and Ikumo Isono “Impact of Free Trade Agreements on Business Activity in Asia: The case of Japan” *ADB Working Paper Series* No 143 (July 2009)

important ways and when we must contemplate many agreements rather than components of a single compromise.

Nevertheless, the future world probably will be different. The wider agenda and greater number of players means that there will be many more bilateral and multilateral agreements. The task is to preserve a multilateral system in the face of change rather than to look nostalgically to the past. That is why forming a region-wide FTA (and linking it other regions) is more than one among a number of challenges; it is the context in which governments will have to address problems like including “agricultural” within comprehensive, and dealing with the Singapore issues and other relatively new elements of economic integration.

2. EAFTA, CEPEA and TPP

The Trans-Pacific Strategic Economic Partnership is unusual in that it is both plurilateral and trans-Pacific. This confers strengths more than problems.

The present P4 is recognized³ as unusually high-quality both for its comprehensiveness and for its incorporation of WTO+ elements. It was always seen as potential vehicle for a wider membership, although any accession, and especially accession by a major economy, would not doubt require specific negotiations. Currently, Australia, the US and Vietnam, have indicated interest in talking about accession with the existing agreement as a framework for those discussions. But like so much else, progress awaits determination by the Obama Administration of its priorities.

Several difficulties have been said to face TPSEP as a vehicle for a region-wide FTA.⁴ First, there is doubt that APEC can change from being a non-binding organization. This implicitly assumes that a region-wide FTA would be a single agreement to which everyone would sign up at once. That would be no easier to achieve than completion of Doha. As suggested earlier, any region-wide agreement is likely to be a set of linked agreements covering a wide agenda and with variable membership and clear criteria for new accessions. Acceptance of this will finally force negotiators to turn away from their comfort zone of preferential tariffs and focus on what is important about economic integration. As a regional economic integration vehicle, TPSEP would have to be compatible with APEC developments, but it could develop as a set of agreements among subsets of the APEC membership. (Indian participation could pose problems but is some distance away. The issue of membership of APEC cannot be pigeon-holed much longer.)

Secondly, there is concern that not all ASEAN members belong or are likely to join soon. This too becomes less significant once we stop thinking about a single black-letter agreement. The notion of ASEAN as occupying the “driver’s seat” in East Asian integration is deeply embedded in rhetoric and commentary, and we will return to it below. However, it is worth noting immediately that the pattern of Asian FTAs is one of hubs and spokes, the hubs being the region’s five largest economies, Singapore, Japan, PRC, India and Korea. There is little sign of ASEAN unity in this pattern. It would be undesirable for any regional initiative to cut across the ASEAN Economic Community, but a looser network which is compatible with AEC would be possible. It would also fit with trends in the foreign policy of a number of ASEAN members, including Indonesia, which are increasingly inclined to treat ASEAN pragmatically rather than see it as an exclusive instrument.⁵

³ e.g. Kawai and Wignaraja “Asian FTAs”, p. 24, appendix table 6

⁴ conveniently summarised in Kawai and Wignaraja “Asian FTAs”, p. 24

⁵ Rizal Sukma “Indonesia’s Future Role in ASEAN and Beyond”, presentation at Victoria University of Wellington, 17 August 2009

CEPEA has been the subject of a “track 2” study, the essential conclusion of which was:

"2. The Track Two Study Group on CEPEA recommends to the Leaders of EAS through their economic ministers that:

(a) CEPEA's objectives and structure be reaffirmed at the Leaders' level so that a solid foundation for the development of CEPEA initiatives can be shared among member countries.

(b) Discussions be commenced immediately among the governments of the member countries on concrete steps to realize CEPEA, as a comprehensive framework which includes cooperation, facilitation, and liberalization. These steps should include an institutional development aspect, where inputs from the private sector and experts are weighed adequately.

(c) The scope of the discussions should include stocktaking of cooperation measures and implementing status of existing ASEAN+1 FTA/EPAs, practical issues on trade such as streamlining of procedures and harmonization of ROOs, and a concrete timeframe for future governmental negotiation and implementation of cooperation, facilitation and liberalization measures."

At a recent Bangkok meeting of Trade Ministers, it was decided to recommend four working groups of officials to consider EAFTA and CEPEA together. i.e. that the two should be dealt with in parallel. There will no doubt be further debate before and at the forthcoming Leaders' meeting.

CEPEA is envisaged to include all members of the East Asia Summit, the 10 members of ASEAN, the three major North Asian economies, China, Japan and Korea, and India, Australia and New Zealand. It is unwise to read too much into words which may be understood a little differently by 16 participants, but terms like “CEPEA initiatives”, “an institutional development aspect”, and “concrete timeframe for future governmental negotiation and implementation of cooperation, facilitation and liberalization measures” all suggest a network of aligned agreements rather than a single conventional FTA. What is unmistakable is the call for clear *government* agreement.

It has been asserted⁶ that the CEPEA study group suggests that ASEAN + 3 should work in the order trade and investment liberalization, facilitation and technical cooperation, while ASEAN + 6 should follow the order technical cooperation, facilitation and liberalization. However, I can find no such order in the CEPEA report and I am advised⁷ "the order in which the CEPEA Report discusses topics is cooperation, facilitation and liberalization but we were careful that this did not suggest any order of priority or order in which arrangements should be attacked. Making progress on the lot is what we envisaged."

There has not been a convenient comparable recent stock-take on an East Asia FTA although there have been at least two reports to ASEAN Plus 3 leaders which made positive recommendations on EAFTA, which the leaders have so far declined to follow. A further study group report on EAFTA is expected. There have been frequent informal suggestions that ASEAN + 3 would be an easier framework than EAS for “functional integration”. (The argument seems to rest heavily on negotiation being easier among fewer parties, but that has to be set against the CGE result that aggregate gains are bigger when there are more members and that those excluded often experience considerable losses.) The term “functional integration” can have many nuances; it clearly intends to exclude some of what has become part of the agenda of APEC, especially the work of the Counter-terrorism task force, and it carries a suggestion of focusing on what are conventionally early chapters in FTAs, including trade in goods, but that leaves unspecified how

⁶ Kawai and Wignaraja “Asian FTAs” p.23

⁷ By Dr Brent Layton, who was the New Zealand participant in the study group.

much it includes of the remaining expansion of “trade negotiations” into “economic integration”. Overlap with even the “human security” agenda is not excluded because in Asia any available instrument will be used to promote co-operation in response to such incidents as typhoons, earthquakes and tsunamis, or cross-border impacts of pandemics. Even more obviously, ASEAN plus Three will want to build on the Chiang Mai initiative and issues of financial integration. APEC has not succeeded in integrating its Finance Ministers Process with the original conception of a process of trade and foreign ministers. Commentators and some officials give too high a priority to administrative tidiness or to interdepartmental rivalries so that a “trade and foreign affairs” process is kept separate from a “finance” one whereas firms look only at opportunities to capture the benefits of economic integration whatever specific area of government is involved. Nevertheless, despite the development of the Leaders Agenda for Implementing Structural Reform the leading edge in some areas of economic integration remains with ASEAN plus Three.

For both CEPEA and EAFTA, a key constraint is the ability of China, Japan and Korea to manage their participation in regional integration. It is usual to recognise difficulties such as Chinese insistence on recognition as a market economy and concerns about conflicts with internal objectives, Korean worries about China’s agricultural competitiveness and about Japan’s competitiveness in manufacture, and Japanese worries about Korean agriculture and fisheries. But these all have a distinctly old-fashioned appearance. Supply chains and cross-border production networks link agriculture to processing industries, and inputs of goods and services to agriculture and are surely the context in which North Asian economic relations should be considered. WTO+ elements are just as important there as elsewhere.

It suits China, Japan and Korea to use ASEAN forums so as to avoid the instability of a three-sided negotiation. In some respects, this is just a small extension of the idea that plurilateral liberalization processes resemble Alcoholics Anonymous in that participants know perfectly well what they should do, and also know that they have the ability to act independently, but they gain reassurance from periodic assembly and sharing of experiences. It also reflects the particular difficulties of tripartite arrangements tending to break into 2 + 1, but it also reflects the genuine difficulty of responding to the need to reconcile entire domestic economic management with the modern process of economic integration. The most hopeful recent signs have been the willingness of China, Japan and Korea to engage, and the unmistakable signals that they are not willing to restrict their progress to a slow pace determined by ASEAN.

It is conventional to suggest a sequence of AEC by 2015, ASEAN + 1, China Japan Korea (whether trilateral or a set of bilaterals), EAFTA by connecting ASEAN + 1 with CJK, CEPEA, East Asia and the US through FTAAP and with Europe through FTAAE. This is a triumph of a wish for tidiness over economic and political reality. We are much more likely to build a network of agreements and sort out the complications they create than to follow an orderly progression. There was a lot of discussion of “sequencing” in New Zealand in the 1980s (as well as more generally), with a consensus that ideally market reforms would reflect relative abilities to respond to opportunities, but the social engineering of the economics journals had little connection with how events unfolded.

Progress by China, Japan and Korea would support either EAFTA or CEPEA. If we proceed with a network of compatible agreements with overlapping memberships, CEPEA and EAFTA might become indistinguishable. The Working Groups recommended by the CEPEA Study are likely to focus on CEPEA despite accepting the ministerial injunction to work in parallel on CEPEA and EAFTA. What would the NZ, Australian and Indian members do while the others talked about EAFTA, especially as talks about specific agreements are likely to involve variable subsets?

Furthermore, there is no reason other than the capability and number of officials required why negotiations cannot proceed simultaneously on TPSEP.

This is equally true of links between East Asia and Europe. FTAAP is likely to be a set of linked agreements rather than a single FTA of a conventional kind and TPSEP may be a vehicle for reaching it. There has been even less thought about agreements with the EU except in the form of bilateral FTAs. We can reflect that agreements with the EU are even more likely to embrace economic integration than agreements with the US although this may not be true of legally-enforceable provisions or regulatory areas.⁸

3. Conclusion

My basic argument is that it is important to think in terms of economic integration rather than familiar trade diplomacy.⁹

Economic research has already followed this course. In particular, the research of the Economic Research Institute of ASEAN and East Asia, ERIA, gives appropriate emphasis to production networks, and the incorporation of the less-developed economies of South-east Asia into the regional process of economic integration.¹⁰ Other research is pointing in the same direction.¹¹

We should not be too concerned about creating a new network of agreements although managing negotiating resources and ensuring compatibility certainly pose problems.

A region-wide FTA, in the sense of a set of linked agreements with variable but open membership and dealing with the modern wide agenda of economic liberalization is a means of attracting understanding and use by firms, a vehicle for addressing the noodle bowl by diminishing the salience and size of preferences in market access, promotes coverage of agriculture, and facilitates progress on WTO+ elements. It can be achieved by management of multiple initiatives.

⁸ Henrik Horn, Petrov C. Mavroidis and Andre Sapis "Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements" *CEPR Discussion Paper* No. DP7317 (August 2009) concludes

- (i) EC agreements contain almost four times as many instances of WTO+ provisions as do US agreements;
- (ii) but EC agreements evidence a very significant amount of 'legal inflation' (i.e., non-legally enforceable provisions) in the WTO+ category, and US agreements actually contain a more of enforceable WTO+ provisions than do the EC agreements; and
- (iii) US agreements tend to emphasize regulatory areas more compared to EC agreements.

WTO+ means that that the PTA goes beyond WTO mandate such as investment protection, trade and competition, labour standards, and environmental standards.

⁹ More generally, we need to think in terms of jurisdictional integration whereby states pool efforts in all the spheres of setting rules, implementing rules, and adjudicating disputes. See M. Petrie, "Jurisdictional Integration: How Economic Globalization is Changing State Sovereignty" Ph.D. thesis, VUW, 2009.

¹⁰ www.eria.org

¹¹ e.g. e.g. Javier Reyes, Martina Garcia and Ralph Lattimore "The International Economic Order and Trade Architecture" *World Economics* and Dieter Ernst "A New Geography of Knowledge in the Electronics Industry? Asia's Role in Global Innovation Networks" *East-West Centre Policy Studies* 54 (2009); the latter is especially interesting in explicitly addressing the connection between supply networks and innovation.