

Regional FTAs in the Asia-Pacific Area:

A Key to Realizing Asian Leadership in Global Governance

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Free Trade: Buzzword or Respected Principle?

Free trade is repeatedly mentioned as an important principle at international economic and trade policy meetings, such as those of the G8, G20, OECD and IMF, and other multilateral meetings and various FTA negotiations, yet nobody has ever believed that it could truly exist. It is an ideal and impossible to be perfectly achieved, just as a perfect vacuum is not a natural phenomenon.

Yet it is not a mere buzzword, but a goal that everybody and every nation should do their best to achieve as much as possible, since its merits are enormous.

Textbook economics describes the basic theory of the merits of competition. Perfect competition achieves optimal allocation of resources, the so-called Pareto optimum, in the overall economy. Consumers can enjoy the lowest prices achieved through competition and producers can enjoy the merits of the most efficient production system based on the lowest costs achieved by the best mix of inputs, such as labor and capital (production facilities), selected under the pressure of competition with rivals. Free trade enables competition between domestic producers and foreign producers in any market.

It may certainly be very difficult to achieve in the real world, but it is still worth trying to achieve, and maximizing the benefits of trade and investment would be a locomotive for economic growth.

I would therefore recommend any country to follow this principle if it wants to realize economic prosperity. In today's globalized world where goods, money, and human beings move easily beyond borders, we need free trade and investment to maximize the benefits of this globalization.

Asia as Key to Expanding Free Trade

Asia has a crucial role to play in realizing free trade around the world. Asia is expected to be a major engine of global economic growth in this century and the sources of that growth are trade and investment. As the largest potential beneficiary of free trade regimes, Asia should be a leader in achieving trade and investment liberalization around the world. It is also a region exposed to changing political risks. With China and India, two of the BRIC nations, the largest emerging economies, Asia could be affected by political instability stemming from the differences in political regimes in the region. Such a risk could be modified by maximizing economic benefits in the region through trade and investment liberalization, including FTAs.

With this in mind, I would like to introduce one of my own ideas about the Regional Comprehensive Economic Partnership (RCEP) to explore the most effective format for a regional FTA, in particular in terms of its membership.

FTAs as New Global Growth Strategy

Economic theories that value free trade as the essential means to achieve economic prosperity have not been well adopted in the real world, and when economies have slowed down, protectionist measures have easily won popularity in politics where short-term concerns often win out over long-term rationale.

However, the recent trend in the trade policies of major countries has shown us exactly the opposite. Though the global economy, in particular the major developed nations' economies, is still suffering from stagnancy following the financial crisis in 2008 and the subsequent euro crisis, the major nations are now adopting FTAs as a growth strategy instead of protectionist measures. This is due not only to improved understanding of economic theories but also to other policies for encouraging growth, given that growing public debt in many developed nations and continuing low interest rates all over the world have reduced the freedom to adopt more stimulating policies. Major developed nations, in these circumstances, have found it necessary to encourage exports to stimulate growth. To achieve this, they are using FTAs to eliminate trade barriers with their close trading partners. In particular, after the WTO Doha Round got stuck, FTAs replaced the WTO as the major means of achieving trade and investment liberalization. Competitive liberalization is now making progress, since countries want to avoid being at a disadvantage in any given market where they could be discriminated against for not having concluded an FTA with that country, compared to its other trading partners who have done so.

Today, there are not only bilateral FTAs but also regional plurilateral FTAs being agreed upon that are playing an increasingly pivotal role in global trade liberalization.

Regional FTAs in Asia-Pacific Area

There are two important regional FTA negotiations in progress in the Asia-Pacific area – the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP). As is well known, Japan is going to join the TPP negotiations in July. Currently there are 11 countries engaged in these talks – the original members Singapore, New Zealand, Chile, and Brunei, and the United States,

TABLE 1

1. Nominal GDP (& proportion to total GDP of ASEAN+6, 2011)

		(100 million \$)	
1	China	72,981	(36.9%)
2	Japan	58,695	(29.7%)
3	India	16,761	(8.5%)
4	Australia	14,882	(7.5%)
5	South Korea	11,163	(5.7%)
6	Indonesia	8,457	(4.3%)
7	Taiwan	4,664	(2.4%)
8	Thailand	3,456	(1.7%)
9	Malaysia	2,787	(1.4%)
10	Singapore	2,598	(1.3%)
11	Hong Kong	2,486	(1.3%)
12	Philippines	2,131	(1.1%)
13	New Zealand	1,619	(0.8%)
14	Vietnam	1,227	(0.6%)

2. Exports (& proportion to total exports of ASEAN+6, 2010)

		(100 million \$)	
1	China	15,804	(36.0%)
2	Japan	7,717	(17.6%)
3	South Korea	4,711	(10.7%)
4	Hong Kong	3,901	(8.9%)
5	Singapore	3,536	(8.1%)
6	Taiwan	2,746	(6.3%)
7	Malaysia	2,412	(5.5%)
8	India	2,232	(5.1%)
9	Australia	2,118	(4.8%)
10	Thailand	1,954	(4.5%)
11	Indonesia	1,578	(3.6%)
12	Vietnam	712	(1.6%)
13	Philippines	591	(1.3%)
14	New Zealand	314	(0.7%)

3. Imports (& proportion to total imports of ASEAN+6, 2010)

		(100 million \$)	
1	China	13,939	(33.9%)
2	Japan	6,940	(16.9%)
3	Hong Kong	4,331	(10.5%)
4	South Korea	4,253	(10.3%)
5	India	3,287	(8.0%)
6	Singapore	3,109	(7.6%)
7	Taiwan	2,746	(6.7%)
8	Australia	2,142	(5.2%)
9	Malaysia	1,899	(4.6%)
10	Thailand	1,846	(4.5%)
11	Indonesia	1,357	(3.3%)
12	Vietnam	1,019	(2.5%)
13	Philippines	776	(1.9%)
14	New Zealand	307	(0.7%)

Source: IMF etc.

Australia, Peru, Vietnam, Malaysia, Mexico and Canada.

The exploratory discussions for the RCEP were initiated by the 10-member ASEAN in November 2011 and expanded to include ASEAN+6 (China, Japan, South Korea, India, Australia, New Zealand) and in November 2012 the ASEAN Summit officially agreed on starting RCEP negotiations. The "Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership" were approved at that time with the aim of completing negotiations by the end of 2015.

According to these principles, any ASEAN FTA partner that did not participate in the RCEP negotiations, subject to terms and conditions to be agreed with all other participating countries could be permitted to join. The RCEP agreement will also have an open accession clause to enable the participation of any ASEAN FTA partner that did not participate in the RCEP negotiations and also any other external economic partners after the completion of the negotiations.

I would like to introduce my personal ideas about the terms and conditions that should be agreed upon by all members of the RCEP for its expansion.

First Condition: Large & Open Economy & its Role in International Trade

Firstly, I believe that all open and large economies should be covered in any Regional Trade Agreement (RTA) in terms of its effect on trade liberalization. Without the participation of an important economic power, an RTA's effect upon trade liberalization would be fairly limited.

As *Table 1* shows, in comparing nominal GDP among the RCEP member countries and Taiwan and Hong Kong, we can see that Taiwan follows Indonesia. In world ranking by nominal GDP (in terms of the US dollar), Taiwan is 26th and Hong Kong is 41st. In the domain of international trade, Hong Kong is fourth and Taiwan is

sixth among the RCEP member countries plus these two regions in terms of the proportion of exports to the total exports of this entire region.

In global terms, Hong Kong is 13th and Taiwan is 17th in international trade. Concerning a similar proportion to total imports, Hong Kong is third and Taiwan is seventh among this regional grouping, and 10th and 18th respectively in overall global terms.

Therefore, in future RCEP negotiations it would be very important to include these two economies in order to make the RCEP a more effective and influential regional FTA, in the same way that the TPP would have a more significant impact upon global trade with the participation of Japan.

The proportion of interregional trade among each RTA member nation to the total trade of all the member countries will be an important criterion in assessing the economic merits of each RTA. This figure among the current members of the RCEP was 45.5% in 2011, but this would rise to 50.4% if both Taiwan and Hong Kong were included. The future participation of these two economies would increase the significance of the RCEP.

In addition, we should not forget the important role played by Taiwan in the trade of high-technology products. For example, the emergence of smartphones is starting to change the mobile phone market significantly. According to the Market Intelligence & Consulting Institute, a think tank affiliated to the Taiwanese government, Taiwan's strength in this sector comes from a wide-ranging supply chain from upstream to downstream, that is to say from the domains of software and hardware to production module and assembly. Such competitiveness has achieved an extremely high growth in Taiwanese smartphone production, higher than 100% in the first half of 2011, and thus the number of smartphones produced in Taiwan has totaled more than 150 million. Other Taiwanese IT products such as Note PCs and digital cameras maintain a very high profile in the world market.

TABLE 2
Contents production in Taiwan
(100 million Taiwan \$)

	2011	2012
Production	6,003	6,338

Source: Taiwan Ministry of Economic Affairs

TABLE 3
Production of Taiwanese contents industry (by area)
(100 million Taiwan \$)

	2011	2012
Digital games	436	407
Computer animation	45	53
Digital publications	716	515
Digital movie, music	594	668
E-learning	332	465
Mobile applications	731	845
Contents software	1,741	1,942
Network service	1,408	1,443
Total	6,003	6,338

Source: Taiwan Ministry of Economic Affairs, October 2012

Trade in such IT products is covered by the Information Technology Agreement (ITA), a plurilateral agreement first drafted at the WTO ministerial meeting in Singapore in 1996 for the elimination of tariffs on PCs, semiconductors, semiconductor-producing facilities, and telecommunication equipment. Participants in the agreement revise their own schedules of concessions and the outcomes are equally redistributed among the WTO member countries on a most favored nation basis in consistency with GATT Article 1.

However, there are other high-tech products which are not covered by the ITA. For example, liquid crystal panels mostly used for electric and electronic devices are not covered by the agreement and China imposes a 5% tariff upon them. Taiwan is the second-largest producer of liquid crystal panels, so if its participation in the RCEP in the future leads to the elimination of such a tariff it would be considered an enormous merit. (Liquid crystal panels are also not covered by the recently concluded Taiwan-China FTA, the Economic Cooperation Framework Agreement (ECFA).)

Taiwan's industrial strength is also seen in the contents business such as movies and music (Tables 2-4). Since the RCEP covers trade in such services, Taiwan's high-quality software services would be taken full advantage of by members of the RCEP if Taiwan participated.

Other than high-tech goods, Taiwan's exports also include high-quality and cheap chemicals and steel. Therefore the entry of such products into the RCEP market without tariffs if Taiwan joins would increase alternatives for production and help achieve a more efficient production process across the whole area.

In the case of numerical control (NC) machines, consisting of numerical controls and other parts as in many other high-technology

TABLE 4
Software production in Taiwan
(million Taiwan \$)

Items	2010	2011	2012 (e)
System integration	86,002	94,017	103,043
IT outsourcing	20,774	25,198	28,978
Commercial software	3,439	3,714	3,557
Information security	8,511	11,049	12,706
Embedded software	9,202	9,375	9,476
IT software total production	127,928	143,354	157,760

Source: Marketing Intelligence & Consulting Institute, January 2013

products, we would need an international partnership in a production process to achieve high quality and low cost in production. Collaboration between Taiwanese and Japanese companies either in Taiwan or in China would be the best way to achieve it. They would win high profits by exporting the products to third countries, including China.

If the highest value-added part of this product which is numerical control is produced by a Japanese firm, the whole product should be mostly considered to be made in Japan in accordance with rules of origin and thus not be covered by the ECFA, though most industrial machines are to be covered by it.

In the case where an NC machine is produced in Taiwan but assembled into a whole machine in China and this final product is exported to the RCEP nations from China, due to the low percentage of the value-added produced in China it would not be subject to the tariff elimination process scheduled in the RCEP, since it would not be considered as made in China.

In summary, in the light of the need to achieve a smooth supply chain of such high-tech goods in the Asia-Pacific area, which is vital to realizing the highest efficiency in production of these key products for economic growth and development in the region, expansion of the membership of the RCEP to include Taiwan should be considered.

Realization of such a smooth supply chain would also contribute to enhanced economic security, since an RTA would boost connectivity in production and make the whole region better prepared for unexpected damage to supply chains caused by such natural disasters as the Great East Japan Earthquake in 2011. The restoration of supply chains would be more easily achieved with such enhanced connectivity in production.

In the light of the size of its economy and trade as well, it goes without saying that Hong Kong should be another candidate for expanded membership of the RCEP.

Second Condition: Equity to Be Preserved among Trading Partners

A regional FTA is thus an important economic and trade policy for encouraging regional trade liberalization and enhancing economic

growth through the expansion of trade. However, it would have political implications for the member countries as well as for non-members, since conclusion of a regional FTA or joining negotiations for an RTA would be considered part of foreign policy as well. Most importantly, I believe political equity must be achieved among the relevant stakeholders. The exclusion of large and open economies from an RTA would be considered unfair and inappropriate in this regard as well. There are some other issues as well related to political equity among the main stakeholders that should be handled prudently in the event of any expansion of the membership of the RCEP.

In the case of such expansion, as recommended above, there are several possible geopolitical implications for each of the main stakeholders in this region.

First, for ASEAN countries, it would have a positive impact on their political status in the region. In founding the RCEP, the concept of ASEAN centrality is a very important principle for the members and thus in accordance with this principle, in order that either Taiwan or Hong Kong can be new members, they would need to conclude an FTA with ASEAN first. This condition for expanding the membership of the RCEP would strengthen ASEAN centrality.

The ongoing negotiation of a Singapore-Taiwan FTA is worth more attention in this context. A successful conclusion of this FTA could lead to an ASEAN-Taiwan FTA, since Singapore is an important member of ASEAN.

Secondly, we should respect the political creed that “Two Chinas should not exist”. Namely, Taiwan is currently a member of the WTO as the Separate Customs Territory of Taiwan and is also a member of APEC as Chinese Taipei. This principle should be strictly observed in the case of RCEP membership expansion. Assuming this, China would also be a beneficiary of this membership expansion, since it is now under pressure from the TPP which could eliminate China from the competitive liberalization in the Asia-Pacific region. China, which still considers itself a developing country, would find the RCEP, which aims at a more moderate trade liberalization in accordance with its stage of economic development, a much more pertinent approach for the country. With more members in the RCEP, China would be in a better position in the power game. In particular, Taiwan is a region with a close relationship with the US. In this regard, with an expanded RCEP China would maintain its political influence in building a larger Asia-Pacific regional free trade zone including the US, such as an APEC FTA. Without this, the TPP could isolate China from the US-led Asia-Pacific trade liberalization process.

Furthermore, preventing Taiwan from aiming to be a member of the RCEP could end up in pushing it to pursue closer relations with nations other than China. It would be damaging for China to lose its good and consolidated foreign relations with Taiwan after the recent conclusion of the ECFA.

Thirdly, expanded membership would also benefit the US, since Taiwan is seriously working on influencing China to adapt its foreign policy to the realities of globalization and be more aware of its responsibilities in global governance, and not simply enjoy the status

of a developing country. With the increasing influence upon China of Taiwan’s soft power and also its development model as a success story, Taiwan’s participation in the RCEP would increase the potential of the US to achieve more productive foreign relations with China.

Needless to say, US-China relations are central to the future of Asian RTAs, and in this light we should consider how possible progress in the US-EU FTA or the US-Taiwan Trade and Investment Framework Agreement (TIFA) could affect the RCEP.

Finally, we need to reflect upon possible rivalries with Hong Kong and Taiwan, which should be considered a political cost of the RCEP membership expansion. Singapore might not welcome Hong Kong’s participation since it considers itself as a business hub in the service sectors and Hong Kong could become a competitor in this field, while South Korea might also consider Taiwan as a threat in terms of economic power and might not welcome its joining the RCEP.

Conclusion

At a time when the WTO is not realizing its mission very well, the competitive liberalization process embodied in FTAs and RTAs could be crucial to achieving free trade. As a leading economic power in Asia, Japan should be taking the initiative in such a regional liberalization process, as well as in international trade. This would be a significant contribution to global governance that would enhance its international status as well as national interests.

More practically, if an expansion of the RCEP as suggested above leads to common membership of the main existing RTAs in Asia and eventually to a single integrated RTA, such as an APEC FTA, it could avoid the co-existence of plural rules of origin and thus simplify trade rules and encourage free trade. Otherwise, different rules of origin among the RTAs with different memberships could be an impediment to trade, though their original intention was to achieve free trade.

Thus, contributing to better global governance could lead to better business opportunities. In order to promote and expand FTAs and RTAs, Japan should do its best to achieve structural reforms in the Japanese economy to enhance the merits of free trade and competition. For example, rationalizing agriculture in Japan to make the domestic market more open to agricultural imports from overseas could make it easier for Japan to take more active initiatives in concluding and expanding FTAs.

This might be the only way for Japan to convince any Asian trading partner reluctant to accept an expansion of RCEP membership for political reasons that the economic benefits of the RCEP would outweigh the political costs in the long run. **JS**

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