

# **APEC Japan 2010**

## **METI/MOFA Process**

**Assessing Progress Made Toward Bogor Goals–**

**Business Perspectives on FTAs among East Asian APEC Members**



Paper prepared by  
Office of Regional Economic Integration  
Asian Development Bank  
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# **Assessing Progress Made Toward Bogor Goals— Business Perspectives on FTAs among East Asian APEC Members**

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## **1. Introduction**

The aim of this paper is to provide an assessment of progress made toward achieving the Bogor Goals of free and open trade and investment amidst the rapid spread of free trade agreements (FTAs) in East Asia since 2000. The focus of the paper is on the two industrialized Asia Pacific Economic Cooperation (APEC) East Asian economies subject to APEC government-led review during the 2010 APEC Summit, i.e., Japan and Singapore. This paper aims to complement such government assessment and provide business perspectives on the impact of FTAs in East Asia and the achievement of the Bogor Goals. The paper relies on firm surveys conducted in 2007-2008 by ADB and its partners, on two (APEC) industrialized economies (Japan and Singapore) as well as four APEC developing economies (the People's Republic of China [PRC], Republic of Korea [hereafter Korea], Thailand and the Philippines). The current assessment is limited to Asian member economies as ADB's terms of reference do not cover those in the western hemisphere (e.g., US and Latin American countries).

The overall conclusion is that Japan and Singapore as well as the other four East Asian APEC economies have made progress towards achieving the Bogor Goals through reductions in MFN tariffs and FTA-led regionalism. In the absence of a Doha trade deal, FTAs have been a vehicle for continuing trade and investment liberalization specifically as economic recovery takes hold—in the wake of declining trade volumes and the nascent protectionism triggered by the global economic crisis (for more details, see Kawai and Wignaraja, 2009a and 2009b). To optimize use of the region's multitude of FTAs, firms need to plan trade businesses more efficiently and effectively under a regime anchored on the region's FTAs. As more APEC economies have sought to use FTAs to liberalise their economies and pursue their development objectives, APEC has accelerated its work in this area to encourage members to conclude comprehensive, high-quality agreements to maximise their contribution to achieving the Bogor Goals (APEC

2005a). In particular, comprehensive FTAs can achieve significant reductions in tariffs on good trade, services barriers and liberalize other areas of economic activity.

Section 2 provides some background on the Bogor Goals. Section 3 deals with the expansion of FTAs in East Asia. Section 4, 5 and 6 highlight findings on FTA use, benefits and costs and rules of origin (ROOs). Section 7 concludes with policy implications for pursuing the Bogor Goals in the next decade.

## **2. The Bogor Goals**

In 1994, eighteen Economic Leaders of the APEC came together at Bogor, Indonesia and underscored economic cooperation towards strengthening the open multilateral trading system; enhancing trade and investment liberalization; and intensifying development cooperation in the Asia-Pacific region. The APEC Leaders announced the so-called “Bogor Goals” including the long-term goal of “free and open trade and investment” in the Asia-Pacific by 2020. Industrialized economies’ have committed to reduce barriers and promote the free flow of goods, services and capital among the member economies in a GATT-consistent manner no later than the year 2010 and the developing economies committed to the same no later than the year 2020. Since then, several efforts have contributed to achieving and assessing the progress made toward the Bogor Goals. This includes the voluntary approaches through Individual Action Plans and Collective Action Plans stemming from the 1995 Osaka Action Agenda. A mid-term stocktake was also undertaken in 2005, which demonstrated that APEC economies have achieved significant liberalisation and facilitation of trade and investment since 1994. The stocktake paved the way for the endorsement of the 2005 Busan Roadmap (APEC 2005a and 2005b). To date, considerable progress has been achieved among APEC member economies in lowering overall average tariff barriers to trade to less than 5%, increasing intra-regional trade share to at least 66% and reducing transaction costs to business.

Concurrently, liberalization efforts are happening at the multilateral and regional fronts—albeit at differing speed. WTO members including Japan and Singapore have slowly revived and aim to conclude the Doha Development Round in 2010. Applied MFN tariffs have also fallen considerably among East Asian APEC economies. It is noteworthy that the two industrialized East Asian APEC members being assessed - Japan (1.6% import-weighted average applied tariff for all goods in 2009) and Singapore (virtually 0%) - have among the lowest tariffs in the industrialised world.

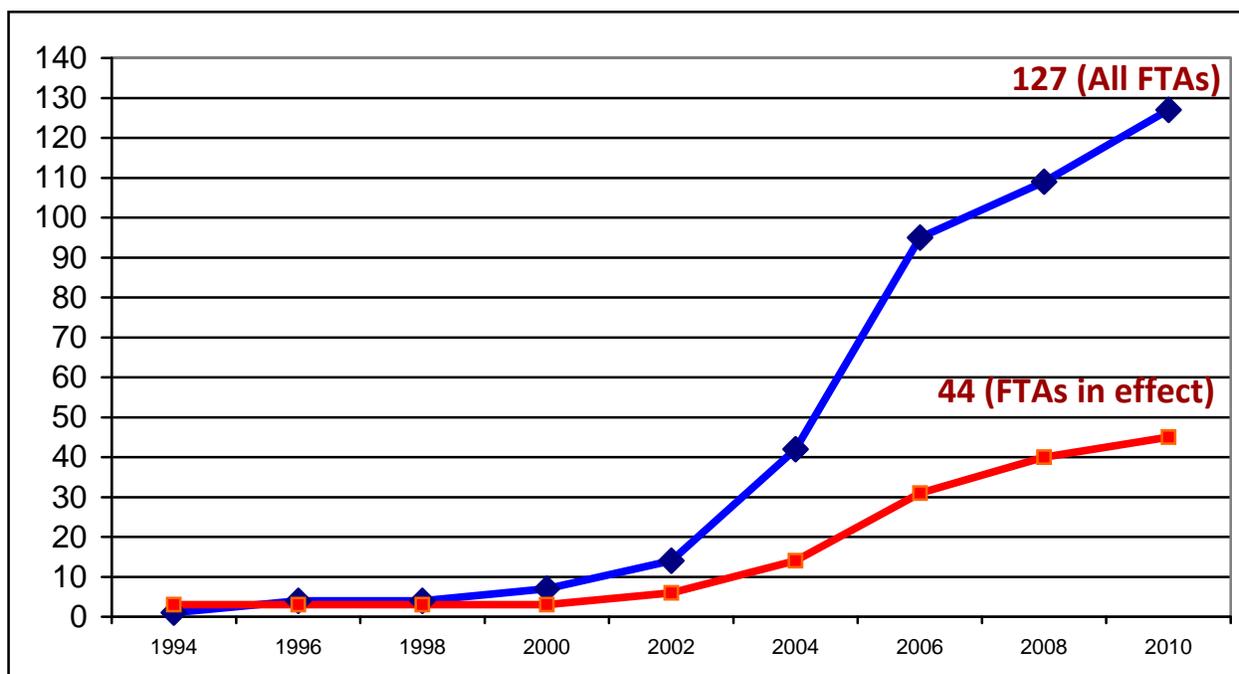
The region has also seen a dramatic growth of bilateral and plurilateral FTAs in recent years, particularly in East Asia as a natural consequence of the region's need to expand trade in the absence of a Doha-round agreement. This has resulted to a lively debate over the impact of FTAs on business in the region and on whether or not the FTAs have net beneficial effects in terms of regional integration particularly in achieving the Bogor Goals, and acting as building blocks to multilateral liberalization.

### **3. The Expansion of FTAs in East Asia**

For the past 25 years, rapid expansion in trade—both to developed markets outside the region and increasingly within East Asia itself—has accelerated the process toward regional economic integration. In addition, foreign direct investment (FDI) brought with it external funding, better production technology and management know-how, and efficient distribution channels linked to outside markets. This long period of market-driven expansion helped East Asia become a global factory by applying existing technologies and then innovating. East Asian firms acquired the technological capabilities to either compete internationally or become suppliers to multinational corporations. In addition, the intraregional concentration of trade and FDI activities rose as production networks involving Asian firms deepened regionally. For example, East Asia's share of intraregional trade as a percentage of total trade increased from 37% to 52% between 1980 and 2008.

East Asia began to emphasize FTAs as instruments of trade policy in the late 1990s. In 2000, only three FTAs were in effect throughout the region. But today East Asia is at the forefront of world FTA activity (see Kawai and Wignaraja 2009b). As of January 2010, there were 44 FTAs in effect, with another 83 in the pipeline (**Figure 1**). The two industrialized APEC East Asian economies have been active players in East Asia FTAs. Japan had 11 FTAs in effect and Singapore 15. Meanwhile, PRC had 9, Korea 5, Thailand 9, and the Philippines 5.

**Figure 1: Growth of FTAs in East Asia**



Note: All FTAs include in effect, signed, under official negotiation, and proposed FTAs. East Asia covers the 10 ASEAN members; Japan; Korea; PRC; Hong Kong, China; and Taipei, China. Source: Asian Development Bank Asia Regional Integration Center (ARIC) Database ([www.aric.adb.org](http://www.aric.adb.org)); data as of January 2010.

Properly designed FTAs keep trade and FDI flowing, even when crisis strikes. Yet, the plethora of overlapping and complex FTAs in East Asia carries the risk of becoming unwieldy and making business cumbersome. Influenced by Bhagwati's famous observation of a spaghetti bowl of FTAs, critics argue that the explosion of deals, with complex rules and variable tariffs, has increased transaction costs, particularly for small- and medium-sized enterprises (SMEs)—those that can least afford them (see Bhagwati, 2008 for an excellent synthesis). They also argue that the multiplicity of bilateral and plurilateral deals hinders the broader push toward a global trade agreements. The spaghetti bowl phenomenon is popularly known as the "Asian noodle bowl" effect and has led Baldwin and Thornton (2008) to propose a "WTO Action Plan on Regionalism" including deepening of the transparency mechanism for FTAs. APEC, in accordance with its 2007 regional economic integration agenda, initiated the process of studying the prospects of and options for a Free Trade Area of the Asia-Pacific and developed 15 model measures for regional trade agreements (RTAs) or FTAs that serve as a reference for APEC members (see Bergsten, 2009).

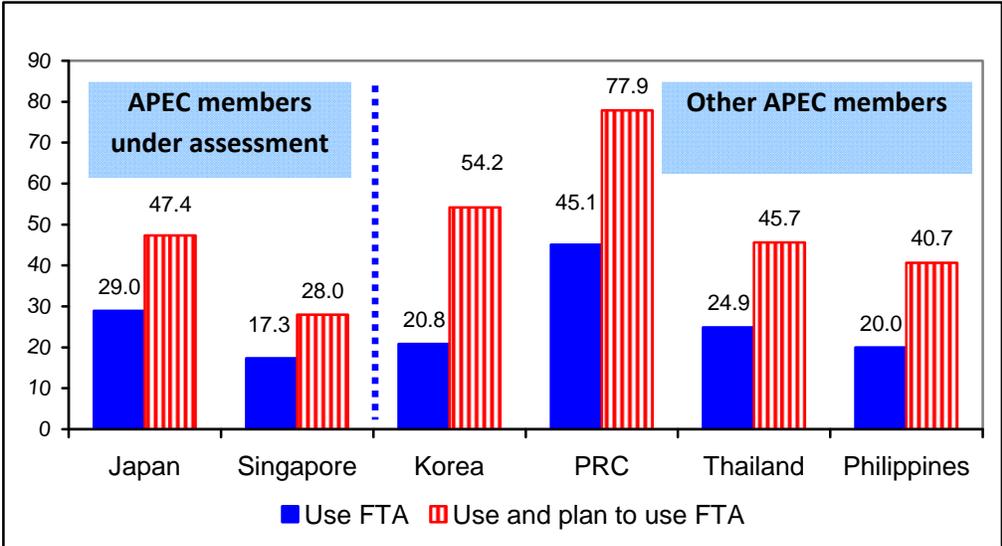
The ADB study on FTAs sought the views of those most directly affected—the region's 841 export-oriented firms. A plurality of the survey's participating firms was from the electronics

sector (32%), followed by the automotive (20%) and textile and garments (17%) sectors. The remaining firms were exporters from chemicals and pharmaceuticals, metals and machinery, and food processing. SMEs (100 or less employees) comprised 32% of the survey sample, “large” firms (100–1,000 employees) made up 44%, and “giant” firms (1000 or more employees) comprised the remaining 21%.

**4. Enterprise Use of FTAs**

Previous country- and industry-level studies suggested low FTA utilization rates in East Asia, with the agreements being viewed as discriminatory and a drain on scarce trade negotiation capacity in developing countries (for an overview see Kawai and Wignaraja, 2009a). The percentage of surveyed firms utilizing FTA preferences was higher than expected based on results from the few existing studies in the region: about 28.4% of responding firms were using FTA preferences while another 53.2% had plans to do so in the future. Firms from the PRC appear to have the highest rate of FTA use at 45.1%. This is followed by Japan and Thailand with 29.0% and 24.9% use rate, respectively. Meanwhile, firms in Singapore, the Philippines, and Korea made the least use of FTAs (Figure 2).

**Figure 2: Utilization of FTA Preferences (% respondents)**



The larger use of FTAs in the PRC was attributed to the aggressive buildup of new and expanding production networks that required channeling resources across the region. Meanwhile, Japan’s relatively high levels of actual (29%) and planned (47.4%) FTA use may be explained by: (i) the presence of giant manufacturing firms that are anchors for regional production networks; and (ii) networks of private sector industry associations and public trade

support institutions that provide services to help businesses adapt to FTA guidelines. Similarly, the relatively high use of FTAs in Thailand is likely the result of the country's emergence as a regional production hub (for example in the automotive sector), high rates of export-oriented FDI, and the government's reliance on FTAs as a tool of trade policy.

The relatively low rate of FTA use among the other countries surveyed may be due to several factors. For example, Korea only entered its first FTA in 2004; Philippines exports are concentrated in electronics, which have low most-favored nation (MFN) tariff rates; and Singapore, even with its high-export orientation and large number of FTA agreements, may find less need for FTA use given its open trading system and low tariff margins.

## 5. Benefits and Costs of East Asian FTAs

Table 1 summarizes enterprise perceptions of benefits and costs of four major FTAs in effect in East Asia. These include: two plurilaterals involving ASEAN (AFTA and the ASEAN-PRC CEPA) and two bilaterals with Thailand's major trading partners (the Japan-Thailand EPA and the Thailand- Australia FTA). Strikingly, East Asian firms typically report more benefits than costs from these four FTAs. The most important benefits include wider "market access" that results in higher export sales and "preferential tariffs" that encourage imports of intermediate inputs. Other benefits include concentration of production to achieve scale economies and new business opportunities including joint ventures. Meanwhile, the main costs are increased competition from imported products and documentation relating to FTA preference use. Minor differences between FTAs are visible on the magnitude of benefits and costs. Under AFTA, for instance, market access and preferential tariffs are both perceived as equally key benefits by firms while market access is the major benefit of the Japan-Thailand EPA.

**Table 1: Benefits and Costs of FTAs**

(No. of firms that reported on the FTAs that they use or plan to use)

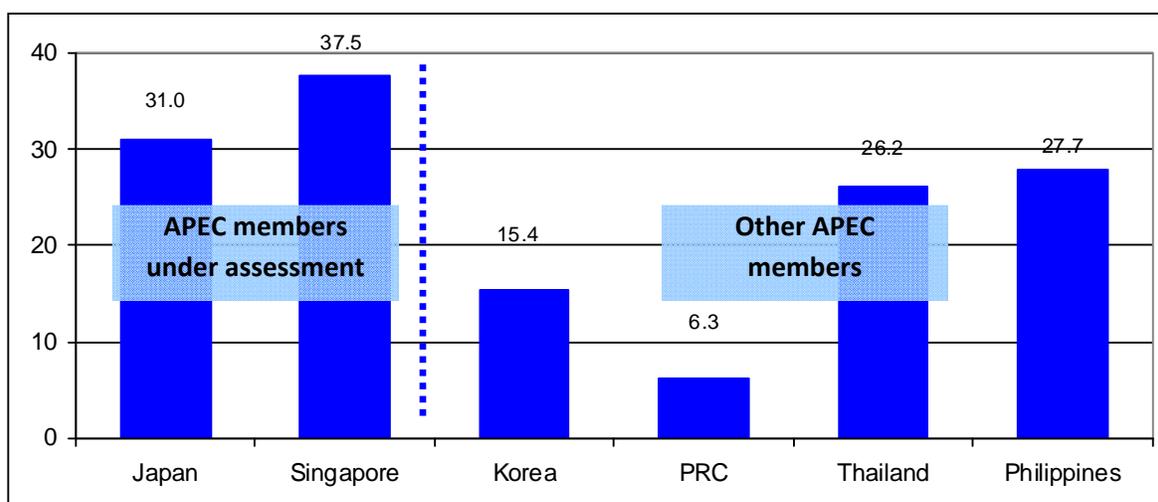
Benefits and Costs of FTA	AFTA	ASEAN-PRC CEPA	Japan- Thailand EPA	Thailand- Australia FTA
<b>Benefits of FTAs</b>				
Market access	36	17	24	5
Preferential tariffs	32	11	11	3
Concentration of production	16	5	13	6
New business opportunities	14	4	9	2
<b>Costs of FTAs</b>				
Increased competition	13	0	5	3
Documentation relating to FTA use	11	2	5	1

Benefits and Costs of FTA	AFTA	ASEAN-PRC CEPA	Japan- Thailand EPA	Thailand- Australia FTA
Competitive disadvantage	7	4	4	0
Relocation of production	10	2	1	1

## 6. Rules of Origin and Trade Facilitation

ROOs are potentially the most challenging aspect of FTAs in East Asia. ROOs determine which goods enjoy preferential tariffs to prevent trade deflection among FTA members. Some studies on FTAs argue that complex ROOs raise transaction costs for firms, while restrictive ROOs deter the use of FTA preferences. However, one key finding of the ADB study is that the region's exporters do not view ROOs as much a burden as widely believed—only 20% of respondents reported that multiple ROOs significantly added to business costs. Incidentally, Chinese firms were least concerned about the burden associated with ROOs (**Figure 3**).

**Figure 3: Burden Imposed by Multiple ROOs in FTAs (% Respondents)**



Across countries in the survey, large and giant firms were more concerned about the costs of ROOs than SMEs. A careful examination reveals that larger, older firms tend to use FTAs more frequently and are thus more familiar with their associated costs, while inexperienced SMEs with a focus on a single market abroad do not find the cost of facing multiple, overlapping ROOs high. The survey results suggest that the fixed costs associated with FTA use—researching various provisions, adjusting business plans to FTA tariff schedules, obtaining certificates of origin, and producing necessary documents—do favor larger, more-established firms with foreign equity over SMEs in terms of FTA use. Firms using FTA preferences reported that

associated costs were outweighed by the primary benefits of wider export market access and lower costs of imported intermediate inputs.

The survey also found that most firms want to choose least cost ROOs among various alternatives offered by overlapping FTAs. In addition to these option or co-equal rules, East Asian FTAs began adopting cumulation, self-certification and other trade facilitation measures (e.g., Japan's automated cargo clearance and Singapore's paperless trading) which have reduced transaction costs to firms.

## **7. Conclusion and Policy Implications**

This study suggests that Japan and Singapore, the two APEC East Asian economies being assessed have made considerable progress towards achieving the Bogor Goals. Both have strongly outward-oriented trade regimes with very low applied MFN tariffs even by APEC standards. In addition, Japan and Singapore have implemented world class trade facilitation measures. Furthermore, both economies are increasingly using FTAs as a tool to pursue further trade and investment liberalization in the region. Other East Asian APEC economies seem to be following suit.

At the current level of FTA activity in East Asia, East Asian FTAs seem consistent with the objectives of Bogor Goals. The results showed that East Asian businesses view FTAs as a benefit rather than a burden, and use them to expand trade to a far greater degree than had been previously thought. The use of FTA preferences was higher than expected. The benefits of FTAs include wider market access and preferential tariffs that make it easier to import intermediate materials needed for finished goods. Evidence suggests that the large majority of exporters did not view ROOs as a significant hindrance to business activity. Nevertheless, as more FTAs under negotiation take effect and the complexity of the Asian noodle bowl increases, the negative business impact is likely to intensify. In particular, multiple ROOs may add to administrative and transaction costs and this could affect the under-utilization and usefulness of FTAs.

APEC policymakers should therefore seek to minimize transaction and administrative costs associated with an array of multiple, overlapping FTAs, while maximizing benefits offered by preferential tariffs and increased market access. In this light, ADB's research offers several measures that APEC policy makers can take in the short-run, including: (i) reduction of MFN tariffs to the extent possible, that can eventually support the conclusion of the Doha round; (ii) rationalization of ROOs (e.g., using APEC best practice guidelines of simplicity and

transparency) and upgrading origin administration (e.g., reducing delays in issuing origin certificates); (iii) making available wider alternative options of ROOs to choose from; (iv) adopting trade facilitation measures; (v) intensifying awareness programs of FTAs among potential beneficiaries including availability of information on ROOs, phase-out tariff schedules and comparison with MFN rates; (vi) getting business more involved in FTA negotiations; and (vii) improving public and private sector support, especially for SMEs.

Also important and of a more medium to long term nature are consolidating overlapping bilateral FTAs into a simpler, region-wide FTA. The multilateral Doha trade talks remain stalled and a variety of bilateral FTAs have spread in its place. A region-wide FTA offers a pragmatic means to implement coordinated trade liberalization than the bilateral route while at the same time mitigating the risk of Asian noodle bowl. One practical way forward might be to take each East Asian FTA's best features and design a "boilerplate regional agreement" that is consistent with the global rules. Accordingly, the paper suggests voluntary good practice guidelines to improve FTA quality and consistency including:

- Cover substantially all trade in goods within a reasonable or even shorter length of time;
- By following WTO, APEC & international best practices, ensure better design and administration of ROOs;
- Cover key services sectors, expand to GATS-plus commitments, and adopt GATS disciplines in services provisions;
- Ensure greater transparency by notifying FTAs in the WTO; and
- Gradually adopt more comprehensive provisions in new FTAs and eventually use a new-age style FTA format with all the Singapore issues (i.e., investment, competition policy, government procurement and trade facilitation) as well as cooperation provisions.

Finally, capacity building through the establishment of a regional FTA advisory center to assist developing countries to achieve compatible FTAs is a complement to the adoption of voluntary good practices and a region-wide FTA. To reap synergies with on-going capacity building efforts, such an advisory center may be established within the APEC Secretariat or within an existing regional institution.

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The collection of working papers— based on surveys of over 800 firms conducted across six countries (Japan, Republic of Korea, People's Republic of China, Singapore, Thailand, and Philippines) is available at <http://www.adbi.org/research.free.trade.agreements.asia.papers/>.