Asia-Pacific
Economic Cooperation

THE NEW INTERNATIONAL ARCHITECTURE IN TRADE AND INVESTMENT

CURRENT STATUS AND IMPLICATIONS

APEC
Human Resources Development Working Group
Capacity Building Network

March 2007

Prepared By

Institute for International Studies and Training

Toranomon Jitsugyo Kaikan
1-1-20 Toranomon, Minato-ku
Tokyo, Japan 105-0001
Tel: (81) 3-3503-6621
Fax: (81) 3-3501-0550
E-mail: info@iist.or.jp
Website: www.iist.or.jp

FOR THE ASIA-PACIFIC ECONOMIC COOPERATION SECRETARIAT

35 Heng Mui Keng Terrance Singapore 119616
Tel: (65) 6775-6012
Fax: (65) 6775-6013
E-mail: info@apec.org
Website: www.apec.org

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Institute for International Studies and Training
Toranomon Jitsugyo Kaikan
1-1-20 Toranomon, Minato-ku, Tokyo, Japan
Tel: (81) 3-3503-6621 Fax: (81) 3-3501-0550
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Preface

One of the important objectives of the Asia Pacific Economic Cooperation (APEC) is to liberalize trade and investment among its members for sustainable development in the region. To this end, APEC has introduced a unique way of promoting liberalization with the voluntary Individual Action Plan (IAP) of each member economy. At the same time APEC has also been supporting the negotiations under the World Trade Organization (WTO) by sending positive messages as a consensus of APEC members.

However, the WTO negotiations have stalled in the midst of the Doha Round. As a result of this disruption in the WTO process, many APEC members have shifted their attention from WTO-based multilateral framework to Free Trade Agreements (FTAs), Economic Partnership Agreements (EPAs) and Regional Trade Agreements (RTAs), which appear to offer a new architecture for international trade and investment. If this is the case, understanding the role and nature of FTAs/RTAs will be essential for parties involved in trade negotiations and analysis. This is particularly important for the business sector, for which the outcomes of FTAs/RTAs have major consequences.

Thus, this project entitled "Capacity Building for the New International Architecture in Trade and Investment" has been carried out as one of activities of the APEC to develop a deeper understanding of emerging trends in the international trade regime and, consequently, the need for increased technical capacity for stakeholders preparing to engage with those trends.

For the first phase of the project, an international symposium entitled "WTO at 10 – Dispute Settlement, Multilateral Negotiation, Regional Integration" was held in October 2005 at the United Nations University in Tokyo, to review the achievement of WTO in the past 10 years, and to identify the issues of the current WTO negotiations and the prospect of FTAs/RTAs proliferating across the globe. This 3-day symposium was organized with the cooperation of the following organizations: Aoyama Gakuin University (WRC/AGU), Tokyo Keizai University, United Nations University-Institute of Advanced Studies, Japan Association of International Economic Law, Japan External Trade Organization (JETRO), Fair Trade Center, and Institute for International Studies and Training (IIST); in collaboration with the World Trade Organization (WTO), Asia Pacific Economic Cooperation (APEC), and the Japanese government; Ministry of Foreign Affairs, Ministry of Economy, Trade and Industry (METI); with support from Japan Foundation, Japan Keirin Association, and The Asia Club Foundation. Forty-two experts from within and outside APEC economies attended the event as speakers and panelists, and more than 250 senior business people and government officials participated in the program. The gist of the discussion at this event was compiled by the WTO and published by Cambridge University Press, entitled "The WTO in the Twenty-First Century – Dispute Settlement, Negotiations and Regionalism in Asia".

Following the event, an experts' workshop was held in Hawaii in October 2006 to deepen the discussions at the previous symposium and identify more specifically the current status of the FTAs/RTAs negotiations, trends and strategies in selected APEC members. Papers from 12 experts from amongst the APEC member economies were collected to address the distinctive situations of FTA/RTA negotiations in their own economies as well as the common issues amongst them under the intricate webs of multilateral, regional and bilateral trade agreements. It

should also be noted that this workshop was carried out in cooperation with the University of Hawaii.

The final meeting was called in Bangkok in November 2006 to further enhance the papers and also to develop a synthesis report of the discussions through the one and a half-year project. The meeting took place together with an international symposium entitled "WTO at the Crossroads: the Challenges Ahead", which was organized jointly with the Asian WTO Research Network and IIST under the auspices of APEC, receiving support from Thailand Research Fund, Eastern Asia University, Sukhothai Thammathirat Open University, International Institute for Trade and Development, and Stockholm Environment Institute. Twelve experts from APEC member economies were invited to the symposium and the workshop amongst others. The results of the discussions held at the symposium became the rich sources for the working group at the final meeting to summarize the final lessons for the project report.

This publication is a compilation of the papers from the working groups at the Hawaii and Bangkok workshops, and is intended to enhance understanding of the current status, issues and implications of regional agreements which may form a new international architecture for liberalized regime. The full text is also available on the APEC website in downloadable form. Please note that in the papers the term "economy" is used to indicate APEC members, instead of "country" or "nation", as an APEC-accepted nomenclature.

As the project overseer, I would like to express my sincere gratitude for the cooperation extended by the experts and their organizations in making this a successful project through their contributions at various stages; their names appear on the following pages. Special thanks go to Prof Henry Gao for preparing the synthesis report, and to Dr Charles Barrett for his valuable advice throughout the project's implementation. The project owes a great deal to the Fair Trade Center, represented by Mr Takashi Iwamoto, and the Asia WTO Research Network. I hope that the diverse network of experts established through the project will be maintained or even strengthened through on-going discussions and studies in the future.

I would also like to acknowledge the continued support of the officers and staff at APEC Secretariat. Last, but not the least, I would like to express my deep appreciation to my IIST team, lead by Ms Etsu Inaba and Ms Shizuka Ichimasa, for their tireless efforts in managing and finalizing this project.

March 2007

Takato OJIMI
Project Overseer
Vice President and Managing Director
Institute for International Studies and Training (IIST)

List of Participants

Paper Contributors

Economy	Title	Name	Designation	Organization
Canada	Dr	Charles A. Barrett	Senior Executive Advisor	The Conference Board of Canada
Hong Kong, China	Prof	Henry Gao	Assistant Professor	Faculty of Law, The University of Hong Kong
Hong Kong, China	Prof	Rajesh Sharma	Associate Director & Research Fellow	Hong Kong WTO Research Institute
Japan	Prof	Yuka Fukunaga	Associate Professor	School of Social Sciences, Waseda University
Japan	Mr	Takashi Iwamoto	Executive Director	Fair Trade Center, Institute for International Trade and Investment
Japan	Prof	Mitsuo Matsushita	Professor Emeritus	University of Tokyo
Korea	Prof	Dukgeun Ahn	Professor	Graduate School of International Studies, Seoul National University
Malaysia	Mr	M. Supperamaniam	Former Ambassador/Permanent Representative of Malaysia to the WTO	-
Singapore	Prof	Chin Leng Lim	Associate Professor	Faculty of Law, National University of Singapore
Singapore	Mr	Samuel Scoles	Asia Director for International Trade Services	White & Case LLP Singapore Office
Chinese Taipei	Ms	Chaw-Hsia Tu	Researcher, Taiwan WTO Center	Chung-Hua Institution for Economic Research
Thailand	Dr	Lawan Thanadsillapakul	Professor	The Institute for International Economic and Business Law Studies, Sukhothaithammathirat Open University
USA	Dr	Seiji Naya	Professor Emeritus	The University of Hawaii
USA	Prof	Saadia Pekkanen	Professor	University of Washington

Other Experts

Economy	Title	Name	Designation	Organization
Australia	Mr	Jeremy Hobbs	Executive Director	Oxfam International
Australia	Mr	John Lockhart	Independent lawyer	Chambers of John Lockhart
Australia	Mr	Andrew L. Stoler	Executive Director of Institute for International Business	Economics & Law, University of Adelaide

Economy	Title	Name	Designation	Organization
China	Prof	Gong Baihua	Director	Shanghai WTO Affairs Consultation Center
China	Prof	Zhang Yuqing	Advisor	Shanghai WTO Affairs Consultation Center
Hong Kong, China	Prof	Gu Minkang	Professor	School of Law, City University of Hong Kong
Hong Kong, China	Prof	Guiguo Wang	Professor	School of Law, City University of Hong Kong
Italy	Dr	Herbert Kronke	Secretary-General	International Institute for the Unification of Privat Law (UNIDROIT)
Italy	Dr	Ernst-Ulrich Petersmann	Professor/ Joint chair	The European University Institute and its Robert Shuman Centre for Advanced Studies
Japan	Prof	Ichiro Araki	Professor	Department of International and Business Law, Yokohama National University
Japan	Prof	Masayoshi Honma	Professor	Faculty of Agriculture, The University of Tokyo
Japan	Prof	Akira Kotera	Professor	Department of Advanced Social and International Studies, The University of Tokyo
Japan	Mr	Ken Matsumoto	President	KM International Associates, Inc.
Japan	Mr	Manabu Miyagawa	Director	Economic Security Division, Economic Affairs Bureau, Ministry of Foreign Affairs
Japan	Prof	Junji Nakagawa	Professor	Institute of Social Science, The University of Tokyo
Japan	Mr	Soichiro Sakuma	General Manager	Legal Affairs Division, Nippon Steel Corporation
Japan	Prof	Gary P. Sampson	Professor	Institute of Advanced Studies, United Nations University
Japan	Mr	Shigehiro Tanaka	Director of Multilateral Trade System Department	Trade Policy Bureau, Ministry of Economy, Trade and Industry (METI)
Japan	Prof	Yasuhei Taniguchi	Chairman / Professor / Professor Emeritus	Appellate Body, WTO / Faculty of Contemporary Law, Tokyo Keizai University / Professor Emeritus of Kyoto University
Japan	Prof	Shujiro Urata	Professor	Graduate School of Asia-Pacific Studies, Waseda University
Korea	Prof	Seung Wha Chang	Professor	College of Law, Seoul National University
Korea	Dr	Chulsu Kim	Senior Advisor	Lee International IP & Law Group
Korea	Prof	Nohyoung Park	Director	International Economic Law Institute of Korea, Korea University
Singapore	Ms	Margaret Liang	Consultant	WTO and Trade Issues, Ministry of Foreign Affairs, Singapore
Switzerland	Mr	A.V. Ganesan	Member	Appellate Body, WTO
Switzerland	Ms	Valerie Hughes	Director	Appellate Body Secretariat, World Trade Organization (WTO)

Economy	Title	Name	Designation	Organization
Switzerland	Prof	Frieder Roessler	Executive Director	Advisory Centre on WTO Law (ACWL)
Switzerland	Mr	Alan Yanovich	Counsellor	Appellate Body Secretariat, WTO
Chinese Taipei	Dr	Da-nien Liu	Research Fellow	Taiwan WTO Center
Chinese Taipei	Prof	Chang-fa Lo	Dean	College of Law, Taiwan University
Thailand	Dr	Chotiras Chavanich	President	Eastern Asia University, Thailand
Thailand	Dr	Sitanon Jesadapipat	Country Representative	WWF Greater Mekong Programme
Thailand	Dr	Supachai Panitchpakdi	Secretary-General	UNCTAD
Thailand	Dr	Somchin Santawaluk	Deputy Executive Director	International Institute for Trade and Development (ITD)
Thailand	Dr	Surakiart Sathirathai	President	Good Governance for Social Development and the Environment Institute
Thailand	Dr	Pimchanok Vonkhoporn	Head of Bilateral Services Negotiations Section	Department of Trade Negotiations, Ministry of Commerce
UK	Dr	Sol Picciotto	Professor	Law School, Lancaster University
USA	Prof	William J. Davey	Professor	College of Law, University of Illinois
USA	Mr	James P. Durling	Partner	Willkie Farr & Galagher, Washington DC
USA	Mr	Mark Halle	Director and European Representative	International Institute for Sustainable Development (IISD)
USA	Prof	John H. Jackson	University Professor	Georgetown University Law Center
USA	Prof	Merit E. Janow	Member / Professor	Appellate Body, WTO / School of International and Public Affairs, Columbia University
USA	Dr	Deane Neubauer	Professor Emeritus of Political Science	The University of Hawaii
USA	Prof	Gregory Shaffer	Professor / Director	University of Wisconsin Law School / UW European Union Center
USA	Mr	Andrew W. Shoyer	Partner	Sidley Austin Brown & Wood, Washington DC

Overseer's Office

Economy	Title	Name	Designation	Organization
Japan	Mr	Takato Ojimi	Vice President & Managing Director	Institute for International Studies and Training (IIST)
Japan	Ms	Etsu Inaba	Director	Human Resource Development Department, IIST
Japan	Ms	Shizuka Ichimasa	Program Coordinator	Human Resource Development Department, IIST

Chapter

1

THE NEW INTERNATIONAL ARCHITECTURE IN TRADE AND INVESTMENT

CURRENT STATUS AND IMPLICATIONS

Synthesis

Synthesis Report

Prepared by

Henry Gao*

Assistant Professor, Faculty of Law
Deputy Director, East Asia International Economic Law and Policy (EAIEL) Program
The University of Hong Kong, China

The last decade witnessed both the stalemate in multilateral trade negotiations in the WTO and the proliferation of Regional Trade Agreements (RTAs) in various parts of the world, especially the Asia Pacific region. In order to help the policy makers and corporate executives understand the new international architecture, the APEC Human Resource Development Working Group (HRD WG) initiated the Project on Capacity Building for the New International Architecture in Trade and Investment.

As part of the project, a workshop was held in Hawaii from 12-13 October 2006. This workshop brought together experts from several APEC economies, including Prof Dukgeun AHN (Korea), Dr Charles BARRETT (Canada), Prof Yuka FUKUNAGA (Japan), Prof Henry GAO (Hong Kong, China), Mr Takashi IWAMOTO (Japan), Prof Chin Leng LIM (Singapore), Prof Seiji Naya (the USA), Prof Deane Neubauer (the USA), Prof Mitsuo MATSUSHITA (Japan), Prof Saadia PEKKANEN (the USA), Mr Samuel SCOLES (Singapore) and Prof Rajesh SHARMA (Macau, China). During the two day meeting, intensive discussions were held under the theme of "Do RTAs Lead to Creating New International Architecture in Trade and Investment?"

After the Hawaii workshop, a first draft of this report was prepared to summarize the discussions of the Hawaii workshop and to provide a basis for further discussion at the meeting of the working group in Bangkok on 26 November 2006. In addition to the experts who were at the Hawaii workshop, the Bangkok workshop brought together several other experts, including Prof William DAVEY (the USA), Mr Ken MATSUMOTO (Japan), Ambassador Manickan SUPPERAMANIAM (Malaysia), Prof Lawan THANADSILLAPAKUL (Thailand) and Ms Chaw-Hsia TU (Chinese Taipei). At this meeting, the experts held further discussions on the subject, including ways to improve the first draft of the report. Based on these discussions, the report was further revised and now finalized for presentation as a synthesis report to APEC.

* The reporter is grateful to all of the participants at the Hawaii and Bangkok Workshops for their thought-provoking discussions, which form the basis of this report. In particular, the reporter wishes to thank Dr Charles Barrett for his wonderful help in the drafting of this report.

I. Why RTAs now?

Traditionally, most APEC members did not actively participate in RTAs. In recent years, however, more and more APEC members started to jump on the RTA bandwagon. Thus, in the first session, the experts discussed the reasons underlying the members' shift from the multilateral approach to trade liberalization under the WTO to the regional approach under the RTAs. These discussions focused on the following issues.

1. What are the criteria for choosing negotiating partners?

The first step of any RTA negotiation is the identification of negotiating partners. Even though different countries tend to have different considerations, the following list summarizes the most common criterion in selecting negotiating partners.

A. Economic considerations

Theoretically speaking, the main reason for forming RTAs is to promote the economic integration among the members of the agreements. Thus, countries usually attach high importance to economic considerations, which include the following:

First, the higher the complementarities in industrial and trade structures of two economies, the more likely it is for them to enter into RTA negotiations. Thus, Korea chose Chile as its first Free Trade Agreement (FTA) partner because the opposite seasonal environment and the long geographical distance create more opportunities for the two economies to trade in agricultural products. Similarly, for China, an economy that is well-known for its manufacturing prowess, the best RTA partners are those which export mainly raw materials, energy products and agricultural products. Such complementarities create opportunities for gains from trade that are beneficial for the economic developments of all the countries involved. At the same time, by focusing on market access opportunities for the strongest sectors and industries for each economy, the political costs are lessened.

Second, some countries can be used as a backdoor into existing regional economic blocs. For example, Chile was chosen as FTA partner for both China and Korea because it is a member of several important RTAs. Similarly, Japan chose Singapore as its first RTA partner because Singapore had already signed a considerable number of RTAs.

B. Political considerations

Even though in principle economic considerations should be the major driving force for RTA negotiations, in practice political considerations are also important. Indeed, in real-world RTA

negotiations, political considerations are often used to push for RTAs, which do not necessarily make economic sense. There are two types of political considerations, i.e., domestic political considerations and international political considerations.

At the domestic level, RTA negotiations can entail significant costs among domestic interest groups, especially when sensitive issues such as agriculture and textile are involved. Thus, countries generally choose to start with liberalizing sectors that are less controversial. With the experience built up from such easy negotiations, the negotiators can then move on to the more difficult ones.

At the international level, the factors at play are the following:

First, many countries used RTA negotiations as a way to gain geo-political influence in a certain region. This is especially true for regional or world powers with political ambitions in a region. For example, part of the motivation for China to negotiate FTAs with ASEAN countries is to undermine the dominance of the traditional USA-Japan coalition in Asia. To serve its political objectives, China is even willing to sacrifice its economic interests by adopting the guideline of "giving a lot while demanding little" in the negotiation.

Second, by entering into multiple RTA negotiations at around the same time, large countries can foster a competitive relationship among its potential RTA partners. Those which are unwilling to move fast could be severely disadvantaged as the sequence of the conclusion and application of RTAs could entail vastly different economic consequences, with most of the trade being diverted to the ones that were concluded earlier, assuming the product coverage and levels of liberations were similar. As the example of Korea has shown, this strategy, if used well, could enhance the bargaining positions of the hub country.

Third, to avoid over-reliance on a particular region, many countries choose to strike a balance in the regional representations of its RTA partners. Thus, an FTA partner might be selected not because of its economic importance, but because it is from a particular region and could help to diversify the RTA portfolio.

C. Other considerations

There are also several miscellaneous considerations, which include the following:

First, for many countries, especially the Asian countries, being absent from the RTA race is not really an option. As other regions in the world, especially Europe and the Americas, have made significant progresses in regional integration, the Asian countries are under considerable economic pressure to jump on the RTA bandwagon. Otherwise, they will risk losing market share in those economies.

Second, even if a country might not be very keen on entering RTA negotiations with another country, it may still start RTA negotiations in response to the latter's request. Such a negotiation scenario is mostly found in situations where most of the economic benefits would be captured by one country, or where there is strong domestic political resistance to such RTA negotiation due to historical problems between the countries involved.

2. What determines the scope of RTA negotiations?

The scope of RTA negotiations is often determined by the reasons for entering into RTAs, and varies according to the special circumstances of the countries concerned. For example, for RTAs concluded between developing countries, removal of traditional trade barriers is often a major item on the negotiating agenda as developing countries typically maintain relatively high tariffs on both agricultural and industrial products. Also, in many countries, the RTA negotiation processes are increasingly driven by pressures from both domestic and foreign interest groups, which in turn determine the agenda for negotiations. For countries with complementary industrial structures, RTAs could also be used as a way to promote international division of labor, with one economy focusing on agricultural products, while the other economy provides industrial products and services. Some countries have also tried to use RTAs as a way to strengthen the international competitiveness of particular sectors. Indeed, this is one of the most important reasons for Korea to launch RTA negotiation with the US. Due to strong resistance from the domestic industries, however, Korea has not been able to achieve this goal so far.

In terms of the substantive issues, with the traditional trade barriers having gradually fallen in most economies, more and more countries have shifted their negotiating objectives to non-conventional issues, including, for example, intellectual property rights, investment rules, treatment of standards, labor mobility, services, trade and environment issues, etc. Generally, the more advanced the economy, the more important are these issues in RTA negotiations. For example, the USA and Japan have both attached high importance to investment rules and services in their RTA negotiations.

3. What are the true intentions of pursing RTAs behind official rhetoric?

Theoretically speaking, economic benefit should be the main justification for RTAs, and it is often cited by politicians in seeking support for their RTA negotiations. Despite the rhetoric of prompting economic development, however, countries often have hidden agendas for entering into certain RTA negotiations. These include the following:

A. Political reasons:

RTAs which are not necessarily economically beneficial are often negotiated for various political reasons. For example, one of the reasons the USA negotiated the RTA with Viet Nam is to build up trust among the two economies and normalize the political relations. RTAs can also be used to facilitate the economic integration, or even to support ultimate political unification of divided regions. China's Closer Economic Partnership Arrangement (CEPA) with Hong Kong, China is obviously structured with these considerations in mind, and a similar proposal has been made for Chinese Taipei. Also, some RTAs started out mainly as a mechanism to maintain regional security, and economic integration was only brought into the agenda much later. Within

the APEC region the clearest example is the ASEAN, while elsewhere the economic integration of Europe and the creating of the European Union (EU) took place in the context of a clear objective of enhanced political security.

For smaller countries, RTA could also be used as a way to gain geo-political influences. For example, while member countries of the ASEAN are very small compared with their huge neighbors, Japan, China and India, their negotiating positions are significantly improved when ASEAN negotiates as a single group.

As Asia becomes increasingly important as a global engine for economic growth, economies outside of this region also want to use RTAs as a way to ensure their sustainable, constructive engagement in this region. This is well illustrated by the efforts of the USA to negotiate RTAs with several Asian economies. On the other hand, some economies within the region try to use RTAs with other economies in Asia as a means of reducing the economic and political influences of non-Asian economies. This partly explains China's eagerness to negotiate a RTA with ASEAN, which, even though does not bring much economic benefit to China, helps China gain political power in Southeast Asia by enticing the ASEAN countries away from the influences of the USA-Japan coalition.

In addition to international politics, domestic politics can also have strong influence on RTA negotiations. For example, a domestic economic downturn and the ensuing political pressure could make political leaders more willing to try to stimulate economic growth by entering into RTA negotiations. With successful conclusions of RTAs, leaders can in turn further strengthen their position by taking credit for the economic benefits created by RTAs. At another level, the business opportunities brought by RTAs in certain sectors can also be used by officials from the relevant ministries to enhance their status within the bureaucratic power-structure.

B. Miscellaneous reasons:

Several other factors can also influence a country's decision to engage in RTA negotiations. With the Doha Development Agenda (DDA) multilateral trade negotiations in deadlock, more and more countries find that it is better to concentrate their limited negotiating capacity on what they perceive to be more meaningful exercises such as RTAs. This in turn created a "domino" effect, which, according to Pascal Lamy, has been the principle reason behind much of the regional trade agreement activity seen in Asia recently. In some way, RTAs can be used by like-minded nations as a laboratory to make new trade rules or improve upon existing rules. For example, in its RTAs, Korea has created a sui generis trade remedy system, which modifies WTO rules in this regard. As the experience of the EU has shown, RTAs can develop into important regional institutions. Thus, it is important for countries to try to play a ground-up role so that they can exert some influence on the institutional design in the future.

Another interesting phenomenon is that some countries chose to negotiate with trade partners with whom they have relatively low trade volumes. For example, most of China's RTA partners are not among the major trade partners of China. One possible explanation is that China might be trying to diversify the risk of over-reliance on a few economies by diverting some trade to other countries with the creation of RTAs.

II. What are the major issues of RTAs?

In this session, the Experts discussed the major issues of RTAs, including RTAs' consistency with the WTO rules, whether RTAs contribute to creating a new international architecture in trade and investment, and involvement of stakeholders in RTAs.

1. How can RTAs be building blocks for a multilateral system in trade and investment?

In WTO circles, there has long been the debate of whether RTAs are building blocks or stumbling blocks to the multilateral trading system. The Experts agreed that, in order for an RTA to be beneficial to the multilateral trading system, it first has to comply with the WTO rules, which include the following main issues:

A. The legal requirements under Article XXIV and the Enabling Clause

Article XXIV of the GATT lists both substantive and procedural legal requirements for WTO Members to follow before they could invoke the article to justify their RTAs. There are several loopholes, however, within the existing legal framework:

First, the substantive requirements are ambiguous. For example, there is no clear definition as to how much trade coverage could satisfy the "substantially all the trade" requirement under Article XXIV.8. WTO Members disagree with each other as to whether a quantitative or qualitative approach should be adopted. If the latter approach is taken, Members should not exclude important sectors in RTA negotiations. This would create a problem for the Korea-Japan RTA under negotiation, which purports to exclude the agricultural sector. Also, there is disagreement among Members as to whether the term "other restrictive regulations of commerce" under Article XXIV.8 should include trade remedy measures. Even though the Article includes a list of exceptions, Articles VI and XIX are not included in the exceptions. Some Members argue that trade remedy measures are "other restrictive regulations of commerce" and should be eliminated accordingly. Other Members argue, however, that trade remedy measures are not "other restrictive regulations of commerce" and thus should not be affected.

Another related issue is whether a WTO Member could include imports from a RTA partner in safeguards investigations, but exclude such imports from the application of final safeguard measures. In the Argentina-Footwear case, the WTO Appellate Body ruled that such practice would violate the "parallelism" requirement, which means that the imports considered during the investigation stage should be parallel to the imports being subject to the final safeguard measures. This principle is further elaborated by the subsequent US – Line Pipe case and US – Steel Safeguards case, which confirmed that the impact of the imports from RTA partners shall be properly accounted for in an investigation.

Second, even though the WTO also sets out procedural requirements for RTAs, it has been very

hard to enforce them. As the reports of the Committee on Regional Trade Agreements could only be adopted by consensus, the members of non-compliant RTAs can usually block the adoption of any reports critical of their own RTAs. Thus, the procedural review mechanism provided for under Article XXIV has largely become defunct and the WTO disciplines on RTAs could not be effectively enforced.

The Enabling Clause creates further problems in ensuring the consistency of RTAs with WTO rules. Originally drafted to help the developing countries with their economic and trade development, the Enabling Clause provides the legal basis for the Generalized System of Preferences (GSP) provided by developed countries to developing countries as well as regional arrangements among developing countries. The Enabling Clause does not establish any substantive discipline to regulate the RTAs among developing countries, and this makes it virtually impossible to monitor such RTAs.

In practice, some developing countries still follow the substantive requirements in GATT Article XXIV even though their RTAs are notified under the Enabling Clause. The value of the Enabling Clause in these cases lies in the additional flexibility the Enabling Clause provides, even though the relevant nations might choose not to take advantage of such flexibilities in the beginning.

B. Rules of origin

Another problem created by RTAs is the so-called "spaghetti bowl" effect. As RTAs grant preferential tariff rates to member countries, it is important to determine the origins of the products to make sure that only those from RTA members can enjoy such preferences. This creates an incentive for producers to try to relocate their factories in countries with the lowest RTA tariffs, which are not necessarily the most optimal location absent such RTA.

C. Dispute settlement

Many RTAs also have their own dispute settlement mechanisms. There are several benefits of such mechanisms: first, the procedures are usually quicker than that of the WTO; second, the members have broader discretion in choosing the arbitrators; third, the process is more flexible and can better accommodate the needs of the countries.

On the other hand, such mechanisms also have their own problems, the biggest of which is the lack of objectivity as the arbitrators are appointed by the member countries themselves. Also, as the RTA dispute settlement panels could reach different conclusions than WTO panels, this might encourage the member countries to engage in forum shopping. Moreover, according to Article 23 of the DSU, the Members "shall have recourse to, and abide by, the rules and procedures of the [DSU]" when they "seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements". Thus, if a country refers a dispute on certain provisions in WTO agreements to a RTA panel, this could arguably violate Article 23 of the DSU.

2. What are the merits and demerits of RTAs?

Depending on the different perspectives one takes, RTAs can be either beneficial or detrimental. The following summarizes the main merits and demerits of RTAs.

A. Merits

First, the most obvious benefit of RTAs is that new trade opportunities could be created among the members of such RTAs as the trade barriers are lowered or eliminated. That is also the classic trade creation justification for entering into RTAs. Traditionally, the gains of regional economic integration mostly came from the complementarities of the economies within the RTA, i.e. they were based on comparative advantage. Recent evidences from North America and Europe also suggest, however, that regional integration can also produce substantial gains because of the economies of scale and improved market structures based on differentiated products. Thus, full liberalization in trade and investment could be beneficial to countries with homogeneous as well as heterogeneous industrial and trade patterns.

Second, RTAs can also play important roles in making new trade rules. This can be further divided into two levels: improvement upon the existing rules on issues already covered by the WTO agreements, such as the rules on trade remedies, dispute settlement, trade in services, and labor mobility; and introduction of new issues beyond the traditional WTO framework, such as the rules on investment, labor, environment, competition, etc. For some Asian economies that are highly competitive on sectors such as steel, automobiles, and electronics, the rules on investment are particularly important, as such rules could have heavy influence on the development of these sectors as they all require high investments. Thus, it is important for these countries to try to become active rule-makers through the regional initiatives rather than just remain as passive rule-takers in the multilateral trading system.

Third, RTAs can help countries to make structural adjustment to their industries by creating new business opportunities.

Fourth, with the integration of the markets of its member countries, RTAs can enhance the lobbying powers of businesses in the member countries, and in turn increase the support from the private sector to push for regulatory reforms.

Fifth, for many countries with limited resources, RTAs can be used as a tool for securing a stable supply of energy and natural resources. This is one of the reasons for China and Japan to negotiate RTAs with the Gulf Cooperation Council.

Sixth, by engaging in RTA negotiations, officials from the member countries can build up their negotiating skills, which will be very useful for them in multilateral trade negotiations at the WTO.

B. Demerits

First, RTAs are discriminatory by nature. This is in direct contravention to the non-discrimination principle of the WTO and is not conducive to building up trade liberalization at the multilateral level.

Second, every RTA has its own rules of origin. In order to satisfy these rules of origin, the businesses have to relocate to the appropriate country and follow complicated administrative formalities. This greatly increases the transaction costs and distorts the allocation of resources. Indeed, as the tariff barriers in most economies have been rapidly dismantled in recent years, firms often find that the possible tariff-savings under the RTA are too low to justify the extra work required for complying with the complicated rules of origin requirements.

Third, while RTAs do not necessarily generate additional trade or investment due to the problems mentioned above, its effect of diverting trade and investment has been proved by numerous studies. Adding up with the rents RTAs might generate for particular sectoral interests, the total welfare of all countries could still decline as a whole.

Fourth, as RTA negotiations involve fewer countries and have more limited scope of issues than multilateral negotiations, the process will be more vulnerable to lobbying from special interest groups. This could eviscerate the imbalance of the lobbying powers of different interests groups in domestic politics.

Fifth, rather than taking a comprehensive approach, many RTAs choose to exempt from their scope sensitive sectors, with agricultural being a primary example. This will further entrench the negotiating positions of the countries in the WTO and make it more difficult for the countries to reach agreements on these issues in the Doha Round.

3. Does the RTA negotiation process better reflect interests of the stakeholders?

Just as in any trade negotiations, RTA negotiations also affect the interests of many diverse groups. Thus, it is important to make sure that the RTA negotiation process reflects the proper balance of these interests. In addition to the national governments, the following stakeholders are also involved in the RTA negotiation process: the industries, non-governmental-organizations (NGOs), and the general public or consumers. As each group perceives the same RTA negotiation from a different perspective the positions are often not perfectly aligned. For example, governments typically put political consideration as a high priority, while industries are usually pre-occupied with financial implications. Even within the same interest group, there might still be divergent views. For example, while one NGO might wants to ban genetically-modified crops for worries on human safety, another NGO that is primarily concerned with famine relief might want to encourage such research as this is the only way to ensure that people in developing countries have enough food.

In RTA negotiations, conflicts of interest can usually be observed between import-competing industries on the one side, and an alliance of export-oriented industries, domestic user industries

and consumer groups on the other. The former is usually against RTA negotiations, for fear of losing their shares in the internal market, while the latter is usually eager to engage in RTA negotiations, which can bring both more competition and better efficiency in the domestic market and more market access opportunities in the foreign markets. While such diametrically opposed pressures can be observed in negotiations in both the multilateral trading system and the regional initiatives, most countries find that it is easier for them to influence and control the pace and scope of liberalization to appease such interests through RTAs as there are fewer players in RTA negotiations. Moreover, due to the collective action problem, however, the economically weaker interest groups often emerge as the ones that are politically stronger. With such unbalanced influencing power, many RTAs often leave the hard issues unresolved. Such power imbalance is partly attributable to the ignorance of the industries on RTA negotiations. In order to ensure that RTA negotiations reflects the proper economic interest of all relevant domestic groups, there is a need for positive engagement from the governments, which can be built up through transparent and effective consultation process to ensure that inputs from a broad range of interests are represented.

III. Where do we go from here?

In this session, the experts discussed the future development of RTAs and the DDA, the role of regional integration, as well as ways to build up the human and institutional capacity to prepare for the new challenges. The experts also made some policy suggestions for APEC, based on the discussions.

1. Will RTA negotiations further expand and spread? What would happen to DDA?

As RTAs offer more preferential market access opportunities to member countries, this will create an incentive for non-members to try to sign up similar deals for fear of being marginalized. Thus, RTAs will probably continue as a trend in the foreseeable future. In the process, the economies of RTA members will be further integrated. With the enlarged market, the pro-liberalization forces will have more lobbying power and this could help build up the momentum for multilateral trade negotiations. Moreover, with the increased transaction costs brought about by too many RTAs, more and more countries will realize that, in the end, a multilateral trading system based on the most-favored nation (MFN) principle is in the best interest of most players. Indeed, looking back at history, there seem to be cycles with multilateral and RTA negotiations dominating every few years. In this sense, RTAs can be

regarded as building blocks for multilateral trade negotiations. Thus, while RTAs have been blamed for the lack of progress in the DDA, they might well help to resume the DDA negotiations in the near future.

2. Is regional integration necessary and feasible?

In order to facilitate regional integration, there must be a proper institutional platform. Some of the existing institutions might be able to provide such platform. This include the ASEAN Free Trade Area (AFTA), which includes all 10 members of ASEAN; ASEAN+3, i.e., Japan, China and Korea; the East Asia Summit, which includes India, Australia and New Zealand in addition to ASEAN+3 countries; and APEC.

In recent years, some new initiatives have also emerged. These include the following:

a. The East-Asian Community, which would expand from the traditional trade issues to investment, finance, and even environmental protection, good governance, regional security, education and human resources development;
b. A "Mega-Jumbo Jet" approach, in which China, Japan and Korea will form one wing, India will be the other wing, and the ASEAN will be the fuselage.
c. Comprehensive Economic Partnership in East Asia (CEPEA), which will include a comprehensive economic partnership (CEP) within East Asia based on the OECD model in addition to an East Asian Free Trade Agreement (EAFTA).

There are several problems with these initiatives. First, is it necessary or feasible to push for regional integration in Asia? While some experts argue for regional integration to establish a "unified Asian voice", other experts are more skeptical of the idea. Indeed, at least judging from history so far, the concept of a "unified Asian voice" has been more of an illusion than reality. In terms of regional trade issues, for example, India is characterized by high tariff on non-agricultural products, while Japan and Korea both adopt highly protective trade policies in the agricultural sector, with New Zealand and Australia both aggressive exporters of agricultural products. Moreover, unlike North America or Western Europe, there is no common historical, cultural or political heritage in the region, which makes it even more difficult to integrate.

Second, assuming that regional integration in Asia is feasible, which members should such initiatives include? There is an emerging consensus that ASEAN plus three should be the core group, but should the process include India, which is not in East Asia, but is an important economy? If India were included, what about other South Asian countries, such as Pakistan and Sri Lanka? Should the process also include New Zealand and Australia? Traditionally, they have not been not regarded as Asian nations. In recent years, however, they have shifted their main focus to Asia. Should other countries in the Pacific Rim, such as the Pacific Islands nations, the United States, Canada or Latin American countries be included?

Third, which country should play a leading role in the regional initiative? Since the end of the Cold War, the balance of the power in the region as elsewhere has been broken. While the influence of the United States has diminished, China has emerged as an important power in the region. The course of regional integration in Asia will also be shaped by the identity of the leader.

Fourth, what should be the ultimate aim of the regional initiative? Should it focus on the traditional trade liberalization agenda, that is, the lowering of tariff on goods, and the reduction of market access barriers on services? Or should a more comprehensive approach, including issues such as political coordination and cooperation on regional security, or even education, health and infrastructural developments, be adopted?

Fifth, what should be the negotiating approach? Should it be a bottom-up approach, i.e., starting with a core group of like-minded nations, and then gradually expanding to include other countries? Or should it adopt a top-town approach, i.e., start with the broadest membership possible, and then use the forum to negotiate the further expansion of the agenda?

3. What are the capacity building requirements to prepare for the New International Architecture?

Whatever the specifics, in order to prepare for this new international architecture, there is a need to build up the capacity of the stakeholders. This includes the following components. First, a stock-taking exercise is needed to identify and collect the information about the current state of regional integration. This could include case studies on the practices of particular countries, effects of the existing RTA on different sectors. Also, in order to help the policy makers to make the choice between different approaches, it would be helpful to conduct a side-by-side statistical analysis of the gains from trade from bilateral, regional, and multilateral initiatives for APEC economies.

Second, based on such information, a set of best practices on RTAs can be compiled. The publications and databases resulting from such exercises can then be distributed to negotiators, policy makers, and business executives in a series of education and training programs. Such efforts to collect and share information are best done under an institutional framework. International organizations such as the WTO, UNCTAD, and APEC can play some important roles in the process. Similarly, research institutions, such as the Economic Research Institute for ASEAN and East Asia (ERIA), WTO centers in China, the United Nations University, and Asia WTO Research Network can also provide some of the necessary institutional support. Such exercises could help establish a common vision and promote such common vision for regional integration in Asia, laying important ground work for substantive negotiations.

4. Implications for the APEC process

Based on the discussions above, the following are suggestions for further work by the APEC:

a. In order to understand the current state of RTAs, the APEC should start by compiling the existing RTA provisions. Such compilation would help the member economies to understand the details of the different RTAs in place, as well as allow them to compare the differences between the various RTAs. A study could also be made to compare the gains from bilateral, regional and multilateral initiatives.

b. Based on these compilations, APEC would then draft model RTAs for economies to use as a reference in real negotiations. Indeed, such a process has been undertaken by the APEC Committee on Trade and Investment (CTI). Such models could address harmonization of terminology, as well as suggested approaches to deal with such issues as trade remedies, domestic regulation or dispute settlement mechanism. Recognizing the differences in the conditions of different economies, there could be alternative models for the member economies to adapt to their specific situation.

c. Even though many international organizations and non-governmental organizations offer a variety of capacity building programs in the region, these programs are not coordinated with each other, resulting in a waste of resources in some cases. For example, two institutions might be hosting similar training programs for similar audiences at around the same time. Better coordination could reduce the duplication of efforts to the minimum, while maximizing the benefits. Thus, APEC could conduct a stocktaking exercise of the existing capacity building programs and coordinate them from a central database.

d. The negotiations of RTAs are better approached in an incremental manner. Thus, APEC shall also support the development of visions for long-term regional integration in stages. A possible sequence could be East Asia integration, Pan-Asia integration, and APEC integration.

e. If structured well, RTAs can play a complementary role to the multilateral trade negotiations. Bearing this in mind, APEC can help the economies to better design their RTA to take advantage of the potential synergy between RTA and the multilateral process.

f. Compared with the RTA approach, a multilateral trading system based on the MFN principle is in the best interest of everyone. Thus, APEC should emphasize the importance of the DDA and endeavor to push for the resumption of Doha negotiations and completion of the DDA.

Chapter

2

THE NEW INTERNATIONAL ARCHITECTURE IN TRADE AND INVESTMENT

CURRENT STATUS AND IMPLICATIONS

Economy Papers

Canada and Regional Free Trade Agreements*

Written by

Charles A. Barrett

Senior Executive Advisor
The Conference Board of Canada

By embracing free trade with The United States in the 1980s, Canada's approach to trade policy changed fundamentally from one espousing gradual multi-lateral liberalization under the General Agreement on Tariffs and Trade (GATT) almost exclusively, to one based on a two-track approach, with both bilateral (subsequently regional) and multilateral pillars. What were the original reasons behind this shift in policy and what have been its consequences viewed from the perspective of the experiences of last two decades? Moreover, to what extent has the change in direction been sustained?

1. Historical Perspective

By way of background Canada was one of the 23 original contracting parties to the GATT and participated in all of the rounds of multilateral trade negotiations (MTN) from the 1940s. Canadian officials Canada's fundamental economic interest as being obtaining access for its exporters to The United States market and they felt that it could achieve this objective best through the multilateral process of tariff reduction.

Were it located elsewhere, Canada would be a significant regional power in its own right. But Canada shares the northern part of the North American continent with the world's only superpower. Canada has always lived in the American shadow and feared its might, hence the strong emphasis on multilateral rules-based approaches to international relations.

Indeed, during early MTN rounds Canada was able to play the GATT game well, achieving market access improvements based on relatively moderate reciprocal commitments to its own

market opening. Viewed from this mercantilist perspective, Canada's somewhat limited participation in the Kennedy Round tariff cuts was a "victory."

By the end of the Tokyo Round in the late 1970s some astute Canadian observers sensed that the game was changing, however. As Congress mandated a more litigious approach to safeguarding the interests of US business, the emphasis in Canadian trade policy was set to shift from gradually *improving* access to the US market to *securing* it. As industry restructured along North American lines, Canada sought to minimize the potential negative impact of the presence of the US border on decisions to invest in Canada.

In practice, this latter goal has proved illusive. Nonetheless, constraining the ability of The United States to apply safeguards and other remedies against Canadian exports was one fundamental motivator to embarking on bilateral free trade. The other was the competitive pressure on Canada's manufacturers resulting from the evolution of the global economy and the emergence of new competitors.

From the late nineteenth century Canada's economic development had been based on the so-called "National Policy", a strategy combining the exporting of commodities with industrialization through import substitution and which promoted development in Western Canada to counterbalance the north-south links that North American economic geography favoured.[1] In the early 1980s Canada was in the most severe recession since the 1930s and the limitations of small scale production for the domestic market had become quite apparent. Canada's business leadership, traditionally a strong voice for protection, began to shift ground, realizing that Canada's manufacturing firms could not prosper under the status quo, while Canada's resource exporters —the economy's traditional source of prosperity—could not be counted on for sustained economic growth.

2. Embracing Free Trade in the early 1980s

The final report of the *Royal Commission on the Economic Union and Development Prospects for Canada* was published in 1985. During its three-year mandate the Commission had held hearings from coast to coast and sponsored a wide-ranging research program that eventually encompassed 70 published volumes, covering the gamut of Canada's political economy. Among its many policy recommendations was that Canada take—to quote Commission Chairman and former Liberal federal cabinet minister the Hon. Donald Macdonald—a "leap of faith" by entering into a Free Trade Agreement with The United States.

In many respects the other recommendations of the Commission dealing with labour market reform were more innovative, yet it was the proposal that Canada abandon its century-long policy of protecting its domestic manufacturers that struck a cord with Canadian leaders. In a decisive move the then-new Progressive Conservative government of Brian Mulroney reversed that party's long-standing protectionist stance and began the process of negotiating with the Americans. This was, without question, a bold political step.

The Canada US Free Trade Agreement (hereafter FTA) was extremely controversial at the time and became the central issue in the bitterly fought 1988 federal election. In what was a highly

polemical debate, the case for greater economic liberalization ultimately prevailed over nationalism. The Conservatives were returned to office and the agreement came into effect on 1 January 1989.

While the Macdonald Commission is correctly cited as having been pivotal to a fundamental change in Canada's trade policy, in fact both the perceptions of Canada's elite on the subject of our economic relations with The United States and the reality of North American economic integration evolved. The FTA was not the first step in the rationalization of Canadian industry along north-south lines, nor would it be the last. A sector agreement known as the Auto Pact, which came into effect in 1965, had already transformed Canada's motor vehicles production from strictly low-volume final assembly for the domestic market to producing models primarily for export to The United States.[2] The industry thrived in Canada, to the point that the province of Ontario has become the largest producer of vehicles on the continent, surpassing even Michigan.

Nor did the process stop with the implementation of the FTA. In the early 1990s President Salanis proposed that Mexico also negotiate a free trade agreement with The United States. Rather than see its preferential access to the American market eroded, Canada asked to join the discussions and so the North American Free Trade Agreement (NAFTA) was born, coming into effect in 1994. Interestingly, NAFTA proved to be highly controversial in The United States and some aspects of the agreement have also been unpopular in Mexico. But for Canada the big debate had already taken place at the time of the original Stand so Canadians entered into the three way partnership quite readily.[3]

3. Economic and Other Impacts

Barriers to trade between Canada and The United States were largely eliminated in the 1990sand by 2004 the 10 year NAFTA phase-in period was complete. Thus, the cumulative impact of both agreements on North American production, investment and trade has already occurred. What have been the results?

Without doubt, the FTA and then NAFTA accelerated the already-apparent trend towards continental economic integration. North America is the largest economic area in the world, surpassing Western Europe in both population and GDP. Although it lacks the supranational institutions like the European Commission—indeed all three countries in continental North America place great emphasis on protecting their sovereignty—in many respects the economies are as integrated as those across the Atlantic. Consumer tastes are similar and production and distribution systems are closely aligned.

In the case of the automotive industry, parts may cross international borders several times during the course of the production of a single vehicle and the supply chains in other industries are also complex. Both intra-industry and intra-firm trade are prevalent, with the three North American economies assuming different roles within the same production system, in line with their comparative advantages. Mexico, for example, tends to specialize in more labour intensive activities.

Canada's industry has increasingly focused on production for the whole North American market, with the ratio of exports to production increasing in virtually every industry. In fact, Canada now produces far more manufactures for export than for domestic consumption.

Canada and The United States are each other's largest trading partners, exchanging almost $2 billion per day (See Chart). Canada's trade has become even more focused on the US market, which has accounted for almost 90 per cent of Canada's merchandise exports in some years. Reciprocally, Canada has become more important as a trading partner to The United States, being the number one export market for 39 of 50 states.

US-Mexico trade has also grown rapidly and will inevitably one day surpass trade with Canada, given Mexico's much larger population (in excess of 100 million versus 32 million in Canada). For its part Canada's direct trade with Mexico has also grown quickly, albeit from a small base.

Cross border investment has also boomed, both intra-NAFTA and from outside the region. Canadian-based firms have increasingly ventured beyond its borders, especially in mining, oil and gas, transportation, telecommunications and financial services. Within North America, transportation systems have reoriented themselves to support increasing north-south trade with, for example Canada's two principal railway systems both acquiring lines in The United States, one extending as far south as the Gulf of Mexico.

It is always difficult to isolate the effects of individual trade liberalization initiatives, given the multitude of forces that impact economic performance over a decade and the absence of directly observable information on what would have transpired under the status quo. Nevertheless, there have been many estimates of the outcomes of both the FTA and NAFTA. Despite the fact that the political debates at the time were cast in apocalyptic terms, with both advocates and opponents predicting dire consequences should their view not prevail, the consensus among economists now is that the overall impact of the two agreements was positive, though comparatively modest in scope. For Canada the FTA was the more significant, with a result in the order of perhaps 2 per cent of GDP. But although the gains from trade were impressive, studies using gravity models have also shown that the effect of the Canada-US border has continued to inhibit trade.

Concerns that economic liberalization would compromise domestic policy choice in Canada have, to a great extent, proven not to be the case. To the contrary, an improving economic performance has given Canada the means to continue to pursue its own approach to social and cultural policies.

It is also clear that NAFTA was catalytic, dealing with some of the so-called "new" trade policy issues before they could be addressed in the WTO. However, NAFTA has not always worked out in practice as had originally been envisaged. For Canada the dispute settlement mechanisms have not proven to be as nearly watertight as hoped, especially in the case of the on-going dispute with The United States over softwood lumber. In essence NAFTA imposes oversight over whether the three signatories are properly applying their domestic laws. In the case of softwood lumber, The United States chose to ignore the findings of an extraordinary appeal of a NAFTA panel decision, ending any illusion that the NAFTA process could ultimately hold sway over domestic sovereignty. Canadian businesses have just reluctantly agreed to a managed solution to the latest round of the softwood dispute. But despite some views to the contrary, this experience does not entirely negate the value of the NAFTA panels, as in the absence of the

agreement the resolution of that particular dispute would have been no more straightforward. [4]

Other aspects of dispute settlement have also come under scrutiny. For example, all three NAFTA partners have expressed concern in some fashion regarding how Chapter 11, covering investor-state disputes, has been interpreted. The NAFTA rules of origin are complex and there is evidence that some importers find it easier to pay the now-typically low MFN tariffs than to comply with the paperwork required for tariff-free entry. And despite considerable debate no real consensus has emerged on whether NAFTA should be deepened or broadened.

4. Recent Developments

In one sense NAFTA has been a victim of its own success. The growth of North American trade was beginning to stretch the capacity of the continent's logistics infrastructure and create delays at international borders even before 11 September 2001. Since that time there has been a series of steps to address bottlenecks, streamline border management and facilitate trade, as well as much debate on the next stage of the evolution of the North American economy.

For Canada, the focus has continued to be on The United States. Despite the fact the Canada's economic—and indeed overall—relations with Mexico have grown noticeably since NAFTA, the fact is that both of the smaller partners within North America have paid more attention to managing their bilateral relationship with The United States than to building North America as a whole. After 11 September 2001, Canadian officials instinctively focused on Washington, talking quietly of "North America a two speeds." Moving to a customs union with The United States, harmonizing approaches to domestic regulation and even creating a monetary union have been debated by the policy community in Canada, but have generated little interest in The United States.

Indeed, despite some proponents of "grand bargains" and visions of a "North American Community", the emphasis by all three governments has been on the pragmatic and the practical. Looking ahead, it is likely that economic relations on the continent will be managed through a series of deliberate interest-based decisions, without any unified model of North America.

Beyond this continent Canada has participated in bilateral and regional trade liberalization, but only to a limited extent. This has been noticed: The Minister of International Trade in the new federal Conservative government recently indicated that Canada needs to catch up with its competitors in pushing for bilateral and regional trade and investment liberalization.

Following NAFTA, when the US President lacked Trade Promotion Authority (also known as "Fast Track"), there was enthusiasm in Canada for pressing ahead with bilateral agreements. A free trade agreement was signed with Chile, where Canadian mining firms have substantial investment, based on the NAFTA model. Similarly, agreements have been signed with Israel and with Costa Rica, neither of which is a major trading partner.

But elsewhere Canadian attempts at regional liberalization have stalled.[5] Negotiations that commenced with the European Free Trade Association (EFTA), with Singapore and with the so-called "CA4" (El Salvador, Guatemala, Honduras and Nicaragua) are all on hold, generally

because Canadian domestic interests made finding common ground elusive. The Free Trade Agreement of the Americas (FTAA) is also stalled because of fundamental differences between the Untied States and Brazil. Negotiations for a Trade and Investment Enhancement Agreement (TIEA) with the European Union proceeded slowly until last May, when both sides announced that talks would be postponed pending the outcome of the Doha Round. Whether talks will resume now that the WTO process has been suspended is unclear. On a more positive note a Canada-Japan Joint Study is underway and domestic consultations are also being undertaken concerning the possibility of a free trade agreement with Korea, though the latter faces domestic opposition.

5. Lessons

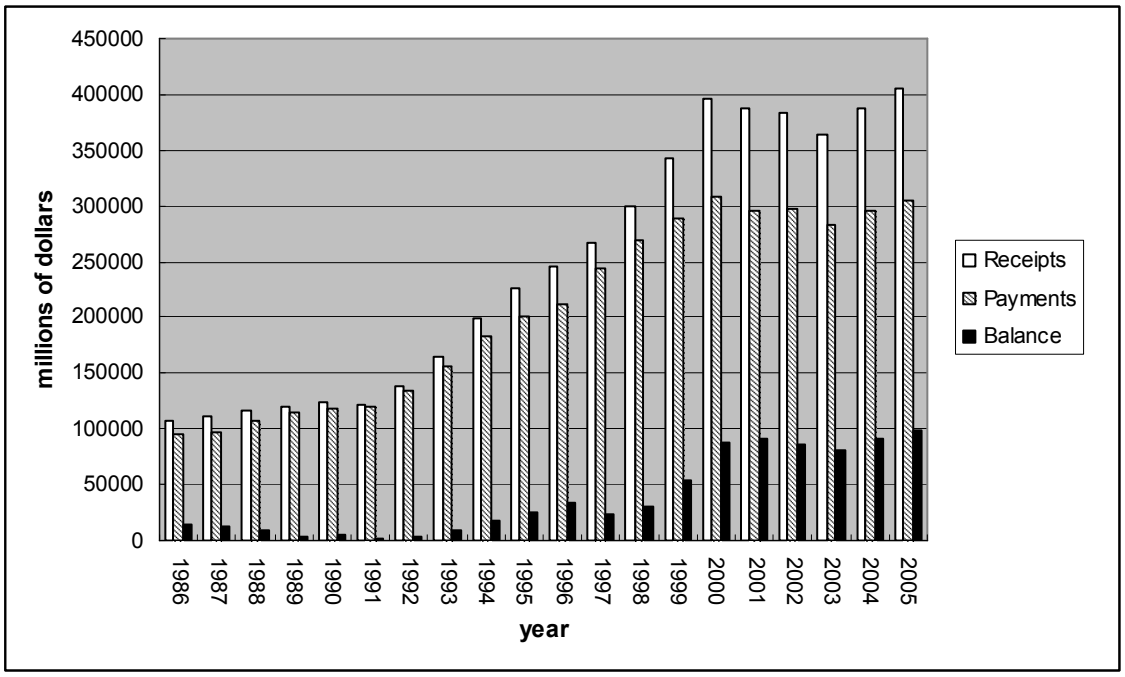
What are the main lessons from the Canadian experience with liberalizing trade with its North American neighbours and its subsequent more reticent approach to regional trade liberalization? First and foremost, while loosening the bounds of protectionism for manufacturing in the 1980s was without doubt a noteworthy step, it was neither the universal remedy for the economy's competitiveness challenge that its most enthusiastic boosters claimed, nor the source of misfortune that its critics predicted. Thus, while integrating into the global economy is a very important dimension of economic policy, globalization is by itself no panacea. Trade policy must be complemented by appropriate adjustments in domestic factor markets and in particular by policies that promote life-long learning and constant upgrading of knowledge and skills. In Canada there is still work to be done to address internal trade barriers and rigidities in domestic factor markets.

Second, major shifts in public policies require both strong political leadership and a high degree of consensus. While competitive pressures made the restructuring of manufacturing a necessary strategy in the 1980s, that change has by no means eliminated protectionist special interests from the Canadian scene entirely. Thus when, where and how leadership will manifest itself remain important issues. While overt protectionism is no longer in fashion except in a few special cases—for example, the supply-managed branches of agriculture—finding domestic champions of further trade liberalization is also increasingly challenging.

Third, despite large asymmetries in power, smaller countries can negotiate mutually beneficial free trade agreements with The United States, provided the objectives and negotiating are clearly spelled out. At at least one critical juncture Canada was prepared to walk away from the original free trade negotiations over lack of progress on dispute settlement. In the end Canada did not achieve everything it wanted in this regard, but it did obtain important and beneficial market access concessions.

Fourth, at least for an economy like Canada and perhaps for many others too, choices regarding the use of multilateral and regional approaches to trade liberalization have been largely pragmatic. Canada has long since abandoned its purist stance in favour of the multi-lateral approach, but it has not become a particularly enthusiastic convert to regionalism. Trade policy will continue to be driven by what is perceived to be possible.

CHART 1: Canada-US Trade in Goods and Services



Source: Statistics Canada Balance of Payments Division, as reported by Canada, Department of Foreign Affairs and International Trade, Trade and Economic Analysis Division http://www.international.gc.ca/eet/pdf/BOP-Canada-US-Annual.pdf

[*] The views expressed herein are solely those of the author and do not represent the official positions of the Government of Canada or The Conference Board of Canada.

[1] Interestingly, the this approach—and indeed the Confederation of British North America of 1867 itself—was an outcome of the abrogation by The United States of a limited free trade arrangement (the 1854 *Reciprocity Agreement*) following the Civil War and as such was clearly a "second best" strategy.

[2] At the time the Auto Pact was negotiated The United States sought and obtained a waiver of GATT Article 24. Canada did not do so on a technicality (the extension of duty remission privileges on a Most Favoured Nation [MFN] basis), which ultimately led to the Auto Pact's undoing when it was challenged at the World Trade Organization (WTO) by governments from non-North American motor vehicle-producing economies. By that time motor vehicle trade within North American was tariff-free in any case.

[3] NAFTA supplemented, but did not replace, the Canada-US FTA, which continues in force.

[4] The softwood lumber issue is extremely complex, involving disparate interests among domestic stakeholders in both economies. While Canada has claimed victory at both the WTO and NAFTA, the actual legal record is mixed and managed trade has proven once again to be the only practical outcome.

[5] I do not include APEC, because of its unique approach to non-binding cooperation.

The RTA Strategy of China: A Critical Visit*

Written by

Henry Gao

Assistant Professor, Faculty of Law
Deputy Director, East Asia International Economic Law and Policy (EAIEL) Program
The University of Hong Kong

Starting with the signing of the CEPA with Hong Kong, China, on 30 June 2003, China has jumped on the RTA bandwagon. As of 1 September 2006, China has signed or is negotiating RTAs with trade partners such as Hong Kong, China; Macau, China; Chile; Pakistan; Australia; New Zealand; ASEAN; Iceland; India and Gulf Cooperation Council. What prompted China's decision to enter into RTAs with other trade partners? What are the costs and benefits of the current RTAs for China? What will be the RTA strategy of China in the future? This paper discusses these questions from a political economy perspective.

1. What is an RTA? (1978-2001)

When China first opened up to the outside world in 1978, its leadership definitely did not have any RTA strategy in mind. Indeed, even at the global stage, RTA was largely an emerging phenomenon. The most well-known RTA in the world, the European Union, did not exist then: there was only the European Economic Community. As to the other regions in the world, they have yet to start regional integration. For China, an economy that just emerged from years of economic crisis and political turmoil, the top priority was trying to recover the domestic economy through the development of export-oriented industries. Thus, even though the Sixth Five-Year Plan for National Economic and Social Development Plan[1], the first comprehensive Economic and Social Development Plan made during the "Reform and Opening-up Era", made "expansion of foreign trade" a primary task, its main focus is import rather than export, i.e., stimulating domestic growth by "making effective use of foreign capital and actively import advanced technologies that fits the needs of domestic development".[2] Neither the Seventh nor

the Eighth Five-Year Plan indicated any interest in RTA either. For example, the Seventh Five-Year Plan, which devoted six chapters to foreign trade, only discusses developing "new international markets"[3] and "foreign aid activities"[4]. Similarly, the Eighth Five-Year Plan focuses on "the further expansion of export trade" only.[5]

There are several reasons that can possibly explain China's lack of interest in the RTA during this era.

First, at least during the first decade of China's reform, China simply was not aware of the possibility of entering into RTAs. Indeed, it was not until 1986, or eight years after China opened up to the outside world again, that China applied to return to the GATT. As China has long been excluded from the GATT, few, if any, people in China then understand what the GATT stands for, and even fewer people would understand what an RTA would entail. Thus, China was still struggling to find an answer to "what is an RTA" rather than asking "why should we enter into an RTA?"

Second, during the 80s and early 90s, the general view is that, an RTA, as its name suggests, is largely a regional initiative.[6] In the Asian Region, however, the RTA concept has not been seriously entertained until the signing of the Framework Agreement on Enhancing ASEAN Economic Cooperation in 1992, which calls for the establishment of "the ASEAN Free Trade Area (AFTA) within 15 years".[7] Even then, other economies in Asia, such as Japan and Korea, were generally reluctant to engage in RTA negotiations. Therefore, China would have difficulties finding RTA partners.

Third, the top priority for China during most of the period was resuming its contracting party status in the GATT. When this proved impossible with the establishment of the WTO in 1995, China tried to step up its accession talks so that it could join the WTO as a founding Member. With most of its resources devoted to the most complicated accession process in the history of the GATT and WTO, China did not have the luxury of engaging in RTA talks.

Fourth, even if China had extra capacity to explore possible RTA deals, it would not be good move for China to start RTA negotiations in tandem with its WTO accession negotiation. On the one hand, any interest in RTA would cast doubt on China's true commitment to the multilateral trading system and make Members more reluctant to negotiate with China at the multilateral level. On the other hand, any serious RTA negotiation would require China to table offers that go beyond what it is willing to offer at the multilateral level. As China was not a WTO Member yet, however, other WTO Members would almost certainly use China's RTA offers as a benchmark to measure its WTO commitments so as to minimize the possibility of diluting the benefits they might obtain under the WTO. Essentially, by entering into RTA negotiations, China could only make its WTO accession negotiations more difficult for itself.

With the publication of the Ninth Five-Year Plan in 1996, China started its policy shift to "actively participate and develop regional economic cooperation", as well as "strengthen 'South-South Cooperation', and promote and develop … the economic and trade cooperation with developing countries".[8] The same Plan, however, also calls for China to "actively participate and defend the global multilateral trading system, develop *both* bilateral and multilateral trade, so that they can promote each other and the market can be diversified" (emphasis added).[9] This seems to indicate that China was not yet ready to fully embrace regionalism yet and tried to find a balance between multilateralism and regionalism/bilateralism.

To some extent, this equivocal attitude also reflects China's frustration over the lack of progress in its accession process, when China first failed to "resume" its contracting party status in the GATT, and then failed to join the newly-established WTO as a founding Member. Moreover, the emergence of regionalism in Latin America (Mercosur, 1991), Southeast Asia (AFTA, 1992) and North America (NAFTA, 1992), in addition to the further strengthening of European economic integration with the formation of the European Union (Maastricht Treaty, 1992) raised fears that China might be left out of the new wave of regional integration. Thus, by giving equal emphasis on both multilateral and regional/bilateral initiatives, China was trying to hedge its risks.

2. The RTA Shopping Spree of China (2001-2006)

Even though China has announced its intention to pursue the RTA track as early as 1996, it did not start to seriously consider the feasibility of the RTA approach until the outbreak of the East Asian Financial Crisis in mid-1997. Whatever its cause, one consequence of the crisis was that people have lost faith in global institutions such as the IMF and World Bank, which were allegedly responsible for the Crisis with their highly-intrusive policy suggestions. Thus, in his speech at the first China-ASEAN summit held in December 1997, President Jiang Zemin calls for the two sides to build a "Good Neighboring Partnership of Mutual Trust".[10] In November 2000, the two sides further agreed in another Summit to explore ways to further enhance integration and economic cooperation between the two regions, including the possibility of establishing a free trade area.[11] After the Summit, an ASEAN-China Expert Group on Economic Cooperation was established to conduct feasibility studies on an ASEAN-China FTA. In October 2001, the Expert Group issued its report and concluded that an FTA would be in the interests of both parties.[12] At the ASEAN-China Summit held a month later, the two sides decided to establish an ASEAN-China Free Trade Area ("ASEAN-China FTA") within 10 years.[13] One year later, the Framework Agreement on Comprehensive Economic Co-Operation between ASEAN and the People's Republic of China was signed, and this marked the start of the tariff-reduction process leading to the eventual elimination of tariffs among the two sides.[14]

For a long time, the ASEAN states have viewed China more as a threat than a potential partner. At first, the ASEAN states were concerned mainly with political and military threats from the north.[15] Indeed, one of the primary reasons for the formation of ASEAN in 1967 was to counter the spread of communism in the region.[16] With China's emergence as one of the most competitive producers of many products in the world, ASEAN started to perceive China more as an economic threat. After all, there is remarkable similarity in their industrial structures: both specialize in labor-intensive products, and both have the US, EU and Japan as their major exporting markets.[17] To a large extent, China's increase in its exports during the last two decades of the twentieth century was achieved at the expense of its neighbors in Southeast Asia. With China's rise as a major exporter, it also started to suck FDI away from its neighbors to the south: as wage levels in China are much lower, it makes sense to invest in China rather than ASEAN states. While before 2001, ASEAN could still take comfort in the idea that China was largely excluded from the many benefits offered by the multilateral trading system, such as MFN, this advantage they enjoyed soon became history with China's accession to the WTO at the end of that year. With its foot into the global trade club, China can now enjoy more predictable access to its major export markets with much lower costs, and this means intensified

competition against ASEAN.[18] Thus, China's call for an FTA at around the same time as its WTO accession is an offer too good to reject: on the one hand, the ASEAN states could not do much to stop China from replacing them in the major exporting markets; on the other hand, with the growth in the domestic market in China, an FTA deal with China, the first of its kind, could guarantee the ASEAN states a first-mover advantage in the largest emerging market in the whole world. The Financial Crisis of 1997 also taught ASEAN states important lessons: First, global institutions such as the IMF and World Bank are not panacea, and it is important to have regional cooperation mechanisms as contingency plans. With the growing importance of China as an economic power, however, any regional cooperation mechanism in this part of the world would not be effective without the participation of China. Indeed, China's decision to not devalue its currency was widely appreciated among ASEAN states as an important factor in helping them go though the period: anyway, should China decided to float the Yuan, the ASEAN states would face more fierce competitions from cheaper Chinese products and this could have greatly eviscerated their problems. While Japan is also an important partner in regional cooperation, Japan was having its own problems during the 90s. Thus, China has become the natural choice. Second, it is important to diversify both their export markets and investment sources. Along with the growth of its domestic market, China also developed an increasingly bigger appetite for overseas investment. For ASEAN states, investments from China is a good way to make sure that their economic well-beings is not tied-up with the economic performances of a few economies.

With the ASEAN-China FTA as a starting point, China has firmly embarked on the road towards RTA. The following years witnessed the signing of the two Closer Economic Partnership Arrangements with Hong Kong, China[19] (June 2003) and Macau, China[20] (October 2003), respectively, the FTA with Chile[21] (November 2005), the launch of FTA negotiations with New Zealand[22] (December 2004), Pakistan[23] (April 2005) (with the conclusion of the Agreement on the FTA Early Harvest Program on the same date)[24], Gulf Cooperation Council[25] (April 2005) and Australia[26] (May 2005), with the negotiation with Iceland set to be launched soon[27]. Also, China have been quite eager in signing an FTA with India, while India has given China cold shoulders over concerns such as the lack of competitiveness of Indian firms[28], the mismatch between the trade patterns[29] and industrial structures[30] of two economies, and security concerns[31]. Moreover, the Indian Commerce Minister Kamal Nath has made clear in 2005 that India would not be prepared to enter into an FTA with China before China becomes a "market economy".[32] This has effectively dismissed any hope for an FTA with China in the near future as the recognition of China's market economy status, at least judged from the FTAs China has signed or is about to sign so far, has become the *Sine Qua Non* of an FTA with China. In the recently-released African Policy Paper, China has also indicated its willingness to "negotiate Free Trade Agreement (FTA) with African economies and African regional organizations" "when conditions are ripe".[33]

Of these FTAs, the two CEPAs are quite different from others. First of all, in terms of the breath of the coverage and depth of the concessions, they far exceeds the RTAs China have concluded.[34] This is understandable as Hong Kong, China and Macau, China are both regions of China, even though they each are separate Members in their own right at the WTO. Also, China has been indicating that it would be willing to enter into similar arrangement with Chinese Taipei, and the generous concessions to Hong Kong, China and Macau, China are probably offered to lure Chinese Taipei into the game. Second, the names of the two arrangements are also very telling. During the negotiations leading to the conclusion of the CEPAs, it has been suggested that they should be called FTAs. In the end, however, they were

named as "Closer Economic Partnership Arrangements" instead. In substance, the two CEPAs are no different from the other FTAs around the world. Moreover, legally speaking, China, Hong Kong, China and Macau, China would run the risk of violating their MFN obligations unless they treat the CEPAs as FTAs, which allow them to invoke the exception provided for under Article XXIV of the GATT.[35] By calling them "arrangements" rather than "agreements", however, the mainland authorities were trying to avoid the impression that China was signing "international agreements". According to many mainland legal scholars, "international agreements" could only be concluded among sovereign states.[36] Conversely, the very fact that Hong Kong, China and Macau, China can now sign "international agreements" with China would mean that they now enjoy sovereign power. While this is not so much of a problem for Hong Kong, China and Macau, China, which has so far been content of being special administrative regions under the Central Government of China, it would be a problem for Chinese Taipei, which has been trying for years to assert its statehood. For the author, this perception is largely based on a misunderstanding of the roles of the WTO agreements and FTAs. As it has been made clear in both the WTO Agreement and the GATT, one does not need to be a sovereign state to be able to join the WTO as a Member,[37] nor does one need to have sovereign power to enter into an FTA.[38] Moreover, if one were to agree that Hong Kong, China and Macau, China, due to their lack of sovereign power, could not enter into "international agreements", then one would have to accept that the two could no longer maintain their WTO Membership, as the WTO agreements are nothing but "international agreements". Another reason for the reluctance of the mainland authorities to admit that the CEPAs are RTAs might be because that the concessions made under the CEPAs are very substantial, and the mainland authorities do not want other WTO Members to try to ask for the same concessions in their negotiations with China: they can simply say that this is some "arrangements" offered by the Central Government to some local governments and thus are off the limits in RTA negotiations with other economies.

As to the other FTAs, Early Harvest Programs and MoUs, a review revealed the following common features:

First, in terms of the geographical distribution of RTA partners, China has tried to strike a balance. So far, China has concluded FTAs, or entered into negotiations, with almost every major region in the world, including Europe, America, Middle East, Africa, East and South East Asia, South Asia, and Oceania. In each region, China usually selects one trade partner to start the negotiations. In the author's view, this seems to indicate that China has some really clever strategy in structuring RTA deals to suit its best interest. One thing all these RTA partners share in common is that they are either RTA themselves, such as the ASEAN and Gulf Cooperation Council, or are members of another RTA deal. For example, Iceland is a member of the European Free Trade Association (EFTA), which has free trade relationship with EU via the European Economic Area (EEA); Chile is an associate Member of both the Mercosur and the Andean Community; while India and Pakistan are both Members of South Asian Association for Regional Cooperation (SAARC). By entering RTA with these partners, China could potentially tap into the bigger markets created by the RTA arrangements that are already in place. This is a highly cost-effective way of exploring new markets.

Second, with the exception of ASEAN and Australia, none of China's existing RTA partners are major trade partners of China. At the same time, however, China is always one of the top five trade partners with these economies.[39] Thus, while China could afford to ignore these economies, none of them could afford to ignore China. With such asymmetric trade relationship,

China could have more bargaining power in the RTA setting than at the multilateral level. This is very important for China as it does not have much experience in trade negotiations. By focusing on RTAs with those economies which are of minor importance to China, China could divert some of the trade with its major trading partners, so that it could further balance and diversify its import sources and export markets and would not be overly-reliant on one or several economies. At the same time, these RTA partners will have a lot of their trade diverted to China. This would further increase their reliance on China and further strengthen China's bargaining power and political clout.

Third, all economies that have entered or are about to enter RTA with China have recognized the market economy status of China. This is mainly concerned with a provision in China's Accession Protocol. As China is an economy with a long history of government planning in economic development, during its accession process, many WTO Members suspected that the Chinese government still interferes with micro-economic activities and thus doubted that the market data in China is really reliable. Thus, Section 15(a) of the Accession Protocol allows WTO Members to deem China as a non-market economy in antidumping investigations. The first step in anti-dumping investigations involves the determination of the existence of dumping, which is derived by comparing the export price and normal value. Normal value is usually the sale price of the product in the exporting economy. This provision, however, would allow WTO Members to disregard the domestic sales price in China and use the prices from some surrogate economies or constructed price. Because the comparative advantages of China mostly come from the low costs of its factors of production, this provision makes it more likely for other WTO Members to arrive at a higher normal value and thus easier to determine the existence of dumping. This mechanism is available to WTO Members for up to 15 years after China's Accession. As this provision is highly technical, it was hardly noticed before and in the first couple of years after China's accession. In recent years, however, as more and more Chinese firms are subject to antidumping investigations abroad, people started to realize the damaging effect of this provision. Indeed, it was largely because of this provision, along with several other discriminatory provisions in China's accession package, that Mr Long Yongtu, the outspoken former chief negotiator in China's WTO accession, was called a "traitor" and likened to Li Hongzhang, the nineteenth century diplomat who allegedly sold China out by signing unequal treaties with Western imperialist powers on behalf of the late Qing government. The Chinese government was embarrassed with such criticism and tried to get rid of this provision. Theoretically, they could have the Accession Protocol amended by the WTO General Council, but this would be highly unlikely given that the General Council works on the basis of consensus and so far the only instance where consensus has been achieved was when the Members decided in late July of this year to suspend the Doha negotiations. The remaining option is for China to negotiate with each of its trade partners to recognize China's market economy status. As China has much more bargaining power at the bilateral/regional level, this strategy seems to be working. So far, 37 economies have recognized the market economy status of China.[40] As more and more economies recognize China's market economy status, there would be mounting pressures on those who still deem China as a non-market economy to do just the same.

Fourth, in terms of the trade pattern, these RTA partners mostly export raw materials, energy products, or agricultural products to China, while they import mainly textile products and electronic products from China. In order to maintain its position as the "World Factory", China would need a steady supply of raw materials and energy; also, as most of the agricultural sector in China is not very competitive due to its low per capita land ratio, China needs to ensure

supply of agricultural products in order to free up its labor from agriculture and go into manufacturing. Thus, the RTA partners are probably chosen with these considerations in mind. Moreover, many of the RTAs also include investment provisions, which is another way for China to make sure that it can invest and subsequently control strategic resources.

3. What lies in the future?

With both the Tenth and Eleventh Five-Year Plan calls for China to "actively participate in … regional international economic cooperation",[41] and the 2004 amendment to the Foreign Trade Law added languages encouraging China to "form or participate in regional economic and trade agreements such as customs union agreement and free trade area agreement, and participate in regional economic organizations",[42] it seems that China has been fully converted into regionalism. In the author's view, at least in the foreseeable future, China will continue to pursue RTAs for the following reasons:

First, as regional integration has intensified in recent years in other parts of the world, especially Europe and the Americas, China probably would try to strengthen similar efforts in Asia, especially East and Southeast Asia, so that it would not be marginalized in this new wave of regional integration. Many observers have noted that Europe, the Americas and Asia will be the three main trading blocs in the future. The question for an Asian or East Asian FTA, however, is who is to be the leader. Currently, it seems Japan and China are the two most likely candidates. Given the lack of flexibility Japan has in negotiating on agricultural issues, however, it seems that it would be difficult for Japan to make progress in the near future. Thus, China has taken up the responsibility as the new leader.

Second, China's FTA strategy is also part of a broader plan to address geo-political concerns. Historically, the United States-Japan coalition has exerted considerable political influence in Asia. Indeed, such influence has dragged China into quite a few conflicts and clashes with several ASEAN states during the second half of the twentieth century. With the amazing development in its economy, China once again has the opportunity to rise as a world power. China has maintained that it will adopt a course of "peaceful rise", which is interpreted by Prof. Zheng Bijian, the senior advisor to President Hu Jintao, to mean that:

> "China will not follow the path of Germany leading up to World War I or those of Germany and Japan leading up to World War II, when these countries violently plundered resources and pursued hegemony. Neither will China follow the path of the great powers vying for global domination during the Cold War. Instead, China will transcend ideological differences to strive for peace, development, and cooperation with all countries of the world."[43]

However, the opportunity to seize the leadership role in Asia is too good for China to pass. As it would take quite some time before China could challenge the military dominance of the US in Asia, the economic integration with ASEAN and other economies in Asia will be the way to achieve political ends using economic ways. When the ASEAN economies found out that they

are too dependent on China for their economic well-being, they could hardly ignore the political message from Beijing. Therefore, even though many commentators have doubted the economic benefit to China from an ASEAN-China FTA as the two are competitors on many products, China has adopted the guideline of "give a lot while demand little"[44] in the FTA negotiations as the political significance of such an FTA greatly outweighs economic considerations.

Third, as the Doha Round is not moving forward, RTA has become the only feasible option to achieve trade liberalization. While this holds true for all WTO Members, China in particular has more to gain from bilateral-regional negotiations as it is placed in an awkward position in the current multilateral negotiations. First of all, As a newly-acceded Member, China is required to undertake a lot of commitments, many of which are higher than those of existing WTO members. It is already a humongous challenge for China to try to implement these commitments. After having been in the spotlight for 15 years, what China needs now is some quiet breathing space, which it can only get at the bilateral-regional level as China had to face the annual transitional review and bi-annual TPR in the WTO. Second, with most of its exports concentrated in labour-intensive or resource-intensive products, China would compete with rather than complement the industrial structure of other developing economies. It is no wonder that other developing economies view China as a competitor rather than a friend. Indeed, notwithstanding that the Chinese government has repeatedly held that China is, and always will be, a developing economy, and in spite of the fact that the per capita GDP in China is comparable to that of many LDCs, China is also the third largest trading power in the world and the only one among all developing economies to be among the top five traders worldwide. Thus, on many issues, China's interest is actually closer to that of major developed economies than that of developing economies. Agriculture is one such example: as China imports a large quantity of agricultural products, it is actually not in China's interests to follow the position of most developing economies and demand the elimination of export subsidies. Trade facilitation, one of the four "Singapore Issues," is another such example: as China exports a lot, it is actually in the interest of China to push for the inclusion of trade facilitation in the WTO framework to make the customs process more efficient and cheaper. However, as China has formally joined G-20, the major developing country grouping in the WTO, it would be embarrassing for China to publicly depart from the G-20 party-line in Doha negotiations. At the bilateral-regional level, China would have more flexibility in asserting is true interests.

[*] LLM, London; JD, Vanderbilt. This article benefits from the generous support provided by the Seed Funding for Basic Research at The University of Hong Kong. All errors are the author's own.

[1] This plan was first drafted in 1975 and again in 1978. However, these two drafts were made under heavy influences of the Cultural Revolution and the targets were set too high. In 1980, the Central Government decided to redraft the plan, and the new draft was finally approved by the National People's Congress in December 1982. See http://www.china.org.cn/ch-15/15/f.htm.

[2] Chapter I, Primary Tasks, Part I, Primary Tasks and Overall Goals, Sixth Five-Year Plan, available at http://dp.cei.gov.cn/lszl/lw2.htm.

[3] Chapter XXXIII, Import and Export Trade, Part VI, Foreign Economic, Trade and Technology Exchange, Seventh Five-Year Plan (1986-1990), available at http://dp.cei.gov.cn/lszl/qw7.htm.

[4] Chapter XXXVI, *id*.

[5] Part VI, Foreign Trade, Economic and Technology Exchange, Eighth Five-Year Plan (1991-1995), available at http://dp.cei.gov.cn/lszl/bw7.htm.

[6] The signing of the USA-Israel FTA in 1985 does not change this general view because this FTA is mainly for political purposes, considering that the trade between USA and Israel were rather minimal.

[7] The full text of the Agreement is available at http://www.aseansec.org/12374.htm.

[8] Part VIII, Increase the Scope of Opening-up, Raise the Level of Opening-up, Ninth Five-Year Plan (1996-2000), available at http://dp.cei.gov.cn/lszl/jw9.htm.

[9] *Id*.

[10] The text of the speech is available at http://news.xinhuanet.com/ziliao/2002-10/28/content_610547.htm.

[11] Forging Closer ASEAN-China Economic Relations in The Twenty-First Century, A Report Submitted by the ASEAN-China Expert Group on Economic Cooperation, October 2001, at p.4, available at http://www.aseansec.org/newdata/asean_chi.pdf.

[12] *Id*.

[13] Premier Zhu Rongji Attended the Fifth ASEAN-China Leaders Summit and Gave Important Speech, Xinhua Net, 6 November 2001, available at http://news.xinhuanet.com/world/2001-11/06/content_101950.htm.

[14] The full text of the Agreement is available at http://www.aseansec.org/13196.htm.

[15] The Three Ages of ASEAN, Lecture delivered by Rodolfo C. Severino, Secretary-General of ASEAN at the ARCO Forum of Public Affairs, Kennedy School of Government, Harvard University, 3 October 2002, available at http://www.aseansec.org/12310.htm.

[16] *Id*.

[17] Report at p.15.

[18] *Id*. at p.24.

[19] The full text of the Arrangement is available at http://www.tid.gov.hk/english/cepa/legaltext/cepa_legaltext.html.

[20] The full text of the Arrangement is available at http://www.economia.gov.mo/page/english/cepa_e.htm.

[21] The full text of the Agreement is available at http://www.direcon.cl/documentos/China2/tlc_chile_china_ing_junio_2006.pdf.

[22] New Zealand-China Free Trade Agreement Frequently Asked Questions, available at http://www.mfat.govt.nz/Trade-and-Economic-Relations/Trade-Agreements/China/0-faqs.php

[23] Memorandum of Understanding on the Free Trade Agreement and Other Trade Issues Between The Government of The People's Republic of China And The Government of The Islamic Republic of Pakistan, available at http://gjs.mofcom.gov.cn/aarticle/af/dh/200504/20050400062513.html.

[24] Agreement on the Early Harvest Programme for the Free Trade Agreement between the Government of the People's Republic of China and the Government of The Islamic Republic of Pakistan, available at http://gjs.mofcom.gov.cn/aarticle/af/dh/200504/20050400062422.html.

[25] See China Completed First Round of FTA Negotiations with Six Gulf States, available at http://gjs.mofcom.gov.cn/aarticle/af/ak/200505/20050500088391.html.

[26] Australia-China FTA Negotiations, Subscriber Update, 26 May 2005, available at http://www.dfat.gov.au/geo/china/fta/050526_subscriber_update.html.

[27] See China, Iceland to start FTA talks, Xinhua, 10 July 2006, available at http://www.chinadaily.com.cn/bizchina/2006-07/10/content_637272.htm.

[28] See P Vaidyanathan Iyer & Amiti Sen, India Yes to Bipa, no to FTA/RTA, Financial Express, April 11, 2005, available at http://www.bilaterals.org/article.php3?id_article=1636.

[29] As one article argues, "[India's] exports to China are basically raw materials, ores and steel (accounting for roughly 57% of exports), while China's exports to India are primarily manufactured goods (like electric machinery, electronic and audio-video equipment). Since manufactured goods have a much higher level of duty compared to raw materials, free trade will mean we give away our advantage more than gaining from them. Besides, unless our exports become more diversified, trade will not be sustainable in the long term." http://www.bilaterals.org/article.php3?id_article=1701. See Anjan Joy, The Journey Has Begun, But It'll Take Long To Arrive, Financial Express, India, 20 April 2005, available at http://www.bilaterals.org/article.php3?id_article=1701.

[30] As noted by one article, "[o]ver 50% of China's GDP comes from manufacturing and construction, over 30% from services and just under 15% from agriculture. … In contrast, over half of India's GDP comes from services with

industry and agriculture sharing the remaining less than 50% in roughly equal proportions. … That's where the rub lies. For the Chinese, an FTA focused on trade in goods would enable them to best leverage their comparative advantage. For India, on the other hand, an agreement restricted to or focused on merely free movement of goods across borders would be one that gives Chinese manufacturers ready access to Indian markets without a corresponding benefit for India in its area of strength." See Shankar Raghuraman, Why An FTA Gives Us Cold Feet, Times of India, 9 April 2005, available at http://www.bilaterals.org/article.php3?id_article=1629.

[31] See Monica Gupta, Trade Pact with China Stuck Over Security, Business Standard, India, 8 August 2006, available at http://www.bilaterals.org/article.php3?id_article=5455.

[32] See India-China FTA Will Not Work, Says Kamal Nath , Deccan Herald, available at http://www.deccanherald.com/deccanherald/jul152005/business1732102005714.asp.

[33] China's African Policy, January 2006, http://www.fmprc.gov.cn/eng/zxxx/t230615.htm.

[34] For a discussion of the coverage of the China-Hong Kong, China CEPA, see Henry Gao, The Closer Economic Partnership Arrangement (CEPA) between Mainland China and Hong Kong - Legal and Economic Analyses, TRADING ARRANGEMENTS IN THE PACIFIC RIM: ASEAN AND APEC, III.C.6., Oceana Publications, New York, 2004.

[35] Indeed, China; Hong Kong, China and Macau, China have effectively conceded that the CEPAs are RTAs by notifying them to the CRTA for review.

[36] See e.g. Zeng Huaqun, CEPA: An Overview of the Models of Economic Cooperation between China, Hong Kong, Macau and Taiwan, in Wang Guiguo ed., A STUDY ON THE LEGAL ISSUES CONCERNING REGIONAL ARRANGEMENT, Peking University Press, Dec. 2004, pp. 97-116.

[37] Article XII of the Marrakesh Agreement Establishing the WTO.

[38] Article XXIV.8(b) of the GATT.

[39] See data at the Trade Profiles Page of the WTO website, available at http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E.

[40] 37 Countries Regard China's Market Economy Status, People's Daily Online, 6 January 2005, available at http://www.chinadaily.com.cn/english/doc/2005-01/06/content_406523.htm.

[41] Chapter XVII, Further Open-up, Develop an Open Economy, Part V, Reform and Opening-up, Tenth Five-Year Plan (2001-2005), available at http://dp.cei.gov.cn/lszl/outline05.htm. Chapter XXXVII, Actively Develop International Economic Cooperation, Part IX, Adopt an Liberalization Strategy based on Mutual Benefit, Eleventh Five-Year Plan (2006-2010), available at http://www.gov.cn/ztzl/2006-03/16/content_228841_10.htm.

[42] Article 5 of the new Foreign Trade Law.

[43] China's "Peaceful Rise" to Great-Power Status, Zheng Bijian, Foreign Affairs. New York: Sep/Oct 2005.Vol. 84, Iss. 5; pg. 18.

[44] Remarks on the China-ASEAN FTA by Mr. Bo Xilai, the Minister of Commerce of China, July 21, 2006, available at http://boxilai.mofcom.gov.cn/column/print.shtml?/speeches/200607/20060702702431.

A View on Japan's EPA Strategy

Written by

Takashi Iwamoto

Executive Director, Fair Trade Center
Institute for International Trade and Investment

1. Introduction

As the second largest economy in the world and a leading trading economy, Japan has based its external economic policies on the rules and agreements of **the World Trade Organization** (WTO) and other multilateral frameworks. For a long time, Japan has benefited significantly from the multilateral trade system. In the recent years, however, the multilateral negotiations have made little progress and many economies have shifted their efforts towards bilateral and regional agreements.

Under these circumstances, it is necessary for Japan to develop strategic multi-layered trade policies by accelerating the negotiations of **the Free Trade Agreement** (FTA) and **Economic Partnership Agreements** (EPA) to complement the WTO and the multilateral frameworks. Japan prefers to name its free trade agreements as EPA because EPA will cover not only trade and tariffs but also the rules and arrangements of investment, intellectual property, competition, personnel exchanges and other areas of mutual interest of economies.

There are several strategically important reasons for Japan to pursue EPAs. Japanese companies have invested globally and intensively in Asia. It is, therefore, necessary for Japan to establish practical and transparent investment rules in EPA with Asian economies. Japan has few natural resources such as energy resources and raw materials, so it is of great importance to conclude EPAs with economies which will be able to export such natural resources to Japan.

In the near future, Japan will face decreasing population due to very low birthrate and it has become a crucial issue whether Japan will be able to sustain its social and economic structure. Japan should make good arrangements with EPA partners for personnel exchange to prepare for the future crisis. Today Japan imports 60 % of food. It is very critical for Japan to secure the

food imports. Agriculture is a very sensitive area in the EPA negotiations but Japan should be more flexible to conclude EPAs with the countries which are capable of exporting agricultural products.

2. EPA with East Asia

Japan is undertaking EPA negotiations with East Asian economies. Japan and East Asia have already established relationships of deep mutual economic dependency. Many Japanese companies have invested and placed their production sites throughout the East Asian region. For Japan, East Asia accounted for 44% of import and 47% of export in 2004. The rate of Japan's direct investment in East Asia increased from 11% in 1999 to 26% in 2004. The mutual dependency between Japan and East Asia has been rapidly deepening. Several Japanese makers of automobiles and home appliances have made decisions to use their East Asian production sites as the bases for export to the third economies around the world including Europe, Middle East, India, Oceania and the United States.

In the society of aging population and declining birthrate, economic growth of Japan is expected to be small or even negative in both domestic production and demand. It is, therefore, important for Japan to further strengthen economic relationship with East Asia, where rapid growth is expected in the future. It will enable Japan to bring the power of East Asia into it through various channels of trade, investment, exchange of experts. For strengthening economic relationship, EPA can be very useful.

EPAs with Singapore and Malaysia have been concluded and entered into force. EPA with the Philippines was concluded and signed in September 2006. EPA negotiations with Brunei Darussalam; Indonesia; Thailand and ASEAN as a whole are ongoing. The negotiation of EPA with Viet Nam is expected to launch soon. Unfortunately bilateral negotiation of EPA with Korea has been suspended since November 2004.

EPA negotiation with ASEAN as a whole is very important for Japanese companies which have production sites of parts and finished products in different ASEAN economies because EPA with ASEAN will make it possible to adopt unified area-wide system which cannot be resolved through individual bilateral agreement. It, therefore, contributes to the enhancement of industrial competitiveness of the area-wide economic activities in the region.

For example, when some parts produced in Japan and/or ASEAN economies are further processed into final products in the ASEAN region and are exported to a economy within the region, bilateral FTA may not be able to cover all cases but an EPA with ASEAN as a whole can act as an umbrella for them by establishing a "Made in Japan-ASEAN" criteria. Competitors such as China and India are keen to conclude FTA with ASEAN. Therefore, it is important for Japan to conclude EPA with ASEAN without delay.

EPAs with Thailand and the Philippines include articles on entry to Japan of the professionals such as nurses and caretakers of aged people. As Japan will soon face declining birthrate and aging population, it is very important to establish a good education and qualification programs for the foreign workers as soon as possible.

The bilateral EPA negotiation with Korea has been suspended because there are strong oppositions from Korean industries and agricultural associations of both economies. Moreover, the current political relationship between two economies in the recent years has made it difficult to resume the negotiation. In recent years Korean government has been very active to promote FTA negotiations. Korea has concluded FTAs with Chile, Singapore and EFTA and is now negotiating with ASEAN; Canada; Mexico; the United States and India. It is also conducting feasibility studies with MERCOSUR, New Zealand, China, South Africa and EU. Under these circumstances, Japanese new government should take a positive step forward to resume the Japan-Korea EPA negotiation as soon as possible.

3. EPA with Economies of Other Regions

EPA with Mexico entered into force on 1 April 2005. The agreement with Mexico was urged by the Japanese companies which felt significant handicaps against their European and American competitors operating under FTA with Mexico. When FTA is concluded between the third countries, the companies in the country yet to conclude FTA will be placed in a disadvantageous position.

Japan has concluded EPA negotiation with Chile in September 2006. Chile is a very important supplier of natural resources to Japan and it is aggressively promoting open economic policies including FTA with its major trading partners. Chile already has FTA with 40 economies and economies including the United States, Canada, EU, EFTA, Republic of Korea and China. Therefore, it is very important for Japan to conclude an EPA with Chile in order to be competitive.

Japan and **Gulf Cooperation Council** (GCC) states, Bahrain, Oman, Qatar, Saudi Arabia, United Arab Emirates and Kuwait, decided to launch negotiations on an FTA covering trade in goods and services. A preliminary meeting was held in July 2006. GCC states are important suppliers of crude oil to Japan and it is vital for Japan to maintain a good relationship with GCC.

The joint study group established by Japan and India to examine the possibility of an EPA has met four times since July 2005. Its report is expected soon. India imposes high tariff rates on most goods imported from Japan. Eliminating these tariffs will not only facilitate exports from Japan but also allow Japanese companies operating in India to realize more reasonable procurement because the tariff rates of the imported parts are quite high, for example, auto parts 15%. For investment and services, transparent and liberalized rules need to be prepared in order to improve the business environment for Japanese companies.

Based on “The Australia-Japan Trade and Economic Framework” signed in July 2003, a joint study by the two governments has been conducted on the effects of the liberalization of trade and investment. In the summit meeting held in April 2005, both economies agreed that handling agriculture was a very difficult problem, but also agreed to a joint study for two years on how to enhance the economic relationship in a way suitable for developed economies including the advantages and disadvantages of an EPA. Australia is an important developed economy in Asia-Pacific region and has rich resources such as iron ore and coal. From viewpoint of securing

resources, it is important for Japan to enhance good economic and political relation with Australia.

4. A View on Japan's EPA Strategy

The WTO and other multilateral frameworks are very important for Japan because Japan has trading partners around the world. At the same time, Japan needs to pursue EPAs to cover the areas where multilateral system cannot cover well.

There are several strategically important reasons for Japan to pursue EPAs. These reasons are based on the fact that Japan heavily depends on trade and investment. It is important not only to maintain comparative competitiveness in trade of goods by eliminating high tariffs through EPAs but also to use EPAs strategically for the future interests of Japan.

The followings are the points which Japan should cover by EPAs:

(1) to establish practical and transparent investment rules
(2) to secure the natural resources such as energy, raw materials and rare metals
(3) to establish appropriate arrangements for movement of workers
(4) to secure food imports
(5) to take appropriate measures for environmental problems
(6) to maintain national security

(1) To Establish Practical and Transparent Investment Rules

Japanese companies have invested globally and intensively in Asia. It is, therefore, necessary for Japan to establish practical and transparent investment rules in EPA with Asian economies. As it seems difficult to negotiate an EPA with China for some time, it is desirable to review the Bilateral Investment Treaty with China.

(2) To Secure the Natural Resources such as Energy, Raw Materials and Rare Metals

Japan has few natural resources such as energy resources and raw materials, so it is of great importance to conclude EPAs with those economies that will be able to export natural resources to Japan. EPA with Chile was concluded in September 2006. Japan should also make efforts to conclude EPAs as soon as possible with economies such as Australia, Brazil, South Africa and Canada

(3) To Establish Appropriate Arrangements for Movement of Workers

In the near future, Japan will face to decreasing population due to very low birthrate and aging population. It has become a crucial issue whether Japan will be able to sustain its social and economic structure. The establishment of education and training system is essential to secure good and qualified professionals and workers from abroad. Japan should make good arrangements with EPA partners for personnel exchange to prepare for the future needs.

(4) To Secure Food Imports

Today Japan imports 60% of food. It is very critical for Japan to secure the food imports. Agriculture is a very sensitive area in the EPA negotiations but Japan should be more flexible and conclude EPAs with the countries which are capable of exporting agricultural products, meat and fish. Japan should make efforts to agree on the arrangements with the EPA partners to invest in the farms and fisheries to export the products to Japan. As the world population is growing and developing countries with large population such as China and India will create an enormous demand for food. The development of bio fuel such as ethanol may also reduce the exportation of agricultural products.

Under these circumstances, Japan must realize the drastic reform of domestic agriculture and at the same time establish good relationships with economies that supply food to Japan through EPAs and bilateral agreements.

(5) To Take Appropriate Measures for Environmental Problems

Japan should make every effort to support sustainable development of the World economies and cooperate with EPA partners for this aim. Japan has developed high quality environmental technologies and can help not only EPA partners but also many developing countries. The rapid growth of Chinese economy is causing serious environmental problems and it is a great threat to Japan by acid rain and seawater pollution. Japan should cooperate with China to take effective measures to fight against pollution and global warming. If an EPA with China is not in agenda for the foreseeable future, Japan should make every effort to cooperate with China through bilateral meetings and multilateral fora.

(6) To Maintain National Security

Japan's political relationships with neighboring economies, China, Korea and the Russian Federation are delicate. North Korea is an unpredictable neighbor. Surrounded by these neighboring economies, Japan should make great efforts to maintain its national security, although Japan has a strong and good relationship with the United States. As it looks very difficult to conclude EPA or other form of bilateral agreement with the neighboring economies, Japan should use other fora as APEC and East Asian Summit Meeting to continue dialogue with the neighboring economies.

5. Conclusion

Under the circumstances that the Doha Development Agenda negotiations at the WTO has been suspended and many economies are now making more efforts to promote FTAs and RTAs, Japan should positively pursue to conclude EPAs with the countries commercially and strategically important to Japan in order to maintain comparative competitiveness and secure benefits.

Studies and discussions on East Asian Community are ongoing. This scheme was originally launched to form an economic community for ASEAN plus three (Japan, China and Korea). Recently Japan has proposed to include India, Australia and New Zealand and expand it as a community of 16 economies. Although it may take very long time to agree on the establishment of East Asian Community, it is worthwhile to continue efforts toward it. The discussions of the study group and dialogues at East Asian Summit Meetings are useful to focus on the issues in the region and make efforts to find ways to cooperate.

Since FTA/EPA agreements with Japan's major trading partners such as China, the United States, EU and the Russian Federation are not in sight yet, Japan should use strategically the existing international fora such as APEC, East Asian Summit Meeting and **Asia-Europe Meeting** (ASEM). Also Japan should make every effort to resume the Doha Round negotiation as soon as possible for further trade liberalization and sustainable development of the world economy.

Korea's FTA Policy

Written by

Dukgeun Ahn

Professor of International Trade Law and Policy
Graduate School of International Studies, Seoul National University

1. Current Situation

Korea, whose economy relies considerably upon foreign export markets, had traditionally been antipathetic about regional trade arrangements ('RTAs') that intrinsically cause discriminatory treatment for products from non-party countries. Such policy tendency has been based on the premise that, as an economy with a global trading exposure, RTAs are not helpful to promote Korea's trading interests and that these arrangements may lead to mutually exclusive trading blocs which may undermine the multilateral trading system. Korea therefore participated in regional economic cooperation arrangements such as APEC and took part in a limited number of preferential tariff arrangements such as the Global System of Trade Preferences (GSTP), Trade Negotiations among Developing Countries (TNDC), the Bangkok Agreement Among Developing Member Countries of the Economic and Social Commission for Asia and the Pacific, and since 2000, unilateral tariff concessions to least developed countries. Korea did not however become a party to any RTAs such as the free trade area or customs union. Korea indeed remained as the last two WTO Members that did not establish any FTA relationship with other countries.[1]

This policy toward RTAs was dramatically changed in the late 1990s when the Korean government recognized that it became isolated from most economic integration initiatives and suffered from trade diversion due to tariff disadvantages. The RTAs are increasingly seen as an effective way of maintaining export markets and for inducing foreign direct investment into Korea. On 5 November 1998, the Committee for Internal Economic Policy Coordination chaired by the Prime Minister determined that the Korean government launched the first FTA negotiation with Chile.[2] It was the first time for the Korean government to formally decide on the FTA policy matters. The Government Report submitted to the Trade Policy Review of

Korea in September 2000 clearly denotes the change in policy:

> As an economy that has benefited greatly from the openness in global trade, Korea has traditionally valued the multilateral trading system and has not supported bilateral or regional free trade agreements. Though its commitment to multilateralism is still firm, Korea has recently begun to be more flexible with regard to the FTAs in the world trading system. Korea is now of the view that FTAs, if properly concluded and managed in accordance with relevant rules, can supplement the multilateral trading system and contribute to market opening in the world through bilateral and regional acceleration of trade liberalization.[3]

For the first FTA negotiation, the Korean government established "Korea-Chile FTA Committee" and five working parties on market access, quarantine and standards, investment and service, trade rules, and dispute settlement. On the APEC Summit meeting in September 1999, presidents of both countries agreed to begin the FTA negotiation. Four formal meetings for the FTA negotiation in December 1999, February, May and December 2000 were held before the FTA negotiation was stalled mainly due to the strong opposition from Korean agricultural sectors. The negotiation appeared a failure after the fifth formal meeting in March 2001 could not be held despite the original schedule. But, at the APEC Summit Meeting in Shanghai in October 2001, two countries agreed to continue the FTA negotiation. Finally, on 24 October 2004, both countries announced the conclusion of a bilateral FTA after the full one week negotiation at Geneva. The FTA was signed on 15 February 2003.

TABLE 1: FTA Situation for Korea as of September 2006

FTA Partner	Progress
Chile	Entry into force on 1 April 2004
Singapore	Entry into force on 2 March 2006.
Japan	Formal negotiation began 22 December 2003. Negotiation suspended since the 6th meeting on 1 November 2004.
EFTA (Switzerland, Norway, Liechtenstein, Iceland)	Entry into force on 1 September 2006
ASEAN (Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, The Philippines, Singapore, Thailand, Viet Nam)	Signed "Agreement" on 24 August 2006
Canada	Scheduled to complete the negotiation by the end of 2006
India (Comprehensive Economic Partnership Agreement)	Scheduled to complete the negotiation by the end of 2006
Mexico (Strategic Economic Complementation Agreement)	In negotiation
US	Scheduled to complete the negotiation by June 2007
EU	Began a preliminary meeting on 19 July 2006
China	Working to begin joint study for FTA
MERCOSUR (Argentina, Brazil, Paraguay, Uruguay)	Working on a joint study report for FTA

But, the last hurdle for the first FTA came from the National Assembly of Korea. When the FTA text was moved to the National Assembly for ratification in October 2003, there was vehement opposition especially from congressmen representing farming sectors. After long battles in the legislative body, the first FTA was ratified on 16 February 2004 only with an enormous subsidy package for farming sectors.[4] This first FTA entered into force on 1 April 2004.

There are several reasons why the Korean government chose Chile as the first FTA partner. First, the opposite seasonal environment and the long geographical distance were considered favorable conditions to alleviate agricultural trade and thus problems for domestic agricultural sectors. Second, it wanted to have an access to the Chilean market that already established many FTA relationships.[5] Particularly, they thought that the extensive FTA network of Chile in the western hemisphere might work as an important gateway for Korea to get an access to increasingly integrated American markets. Second, the Korean government thought that the supplementary industry structure of two economies based on traditional comparative advantages would maximize gains from trade incurred by the FTA. Other than those, learning effects from the Chilean FTA experience, sharing similar policy principles for open economies are also noted as relevant factors to choose Chile.

As summarized in <Table 1>, after the first "experimental" or "pioneering" FTA, the Korean government actively pursued FTA policies. In 2006, two more FTAs entered into force. With there three FTAs, one with Latin American country, one with Asian country and one with European countries, the Korean government basically finished a "warm-up" stage of FTA policy implementation. It had accumulated divergent experience to deal with not only geographically different countries, but also developed (Singapore), developing (Chile) and a group of countries (EFTA).

The Korean government then moved to major trading partners for FTA negotiation. The FTA negotiations currently in progress include countries such as the United States, Japan, India and Canada. Also, it is examining the feasibility of FTAs with various countries including the European Communities, MERCOSUR and China. As of September 2006, the primary focus of Korea's FTA policy is concentrated on Korea-US (KORUS) FTA especially due to a tight time schedule under the trade promotion authority granted to the USTR.

2. Major Features

1) Simultaneous multiple FTA negotiation strategy

The Korean government publicly announced the "simultaneous multiple FTA negotiation strategy". In other words, the Korean government has sought as many FTA negotiations as possible at the same time. This strategy is supposed to make up relatively late participation into a FTA race. Also, it is to enhance bargaining leverage of the Korean government by having various alternatives for FTA negotiation. This FTA strategy, however, required substantial expansion of FTA related government capacity. On 10 December 2004, the Ministry of Foreign Affairs and Trade established new bureau, "FTA Bureau", led by a Director-General level official with four departments where more than 30 officials were recruited. One of the problems of the "simultaneous multiple FTA negotiation strategy" is caused by sequential, not

simultaneous, conclusion of FTA negotiations. Sequential conclusion and thereby sequential application of FTAs may entail vastly different economic consequences depending on the order of FTAs, at least unless they are concluded within a relatively short span of time.

2) Comprehensive "WTO plus" approach

Next, the Korean government generally adopts comprehensive "WTO plus" approach for market liberalization undertaken by FTA negotiations. Since trade barriers at borders of major trading partners are typically very low or scarce, Korea endeavors to work on non-tariff issues such as trade remedy system, investment, trade in services, intellectual property protection, cooperation in science and technology. In this regard, it is noted that the Korean government has adopted *sui generis* FTA trade remedy systems.

For example, the Korea-Chile FTA included special safeguard mechanism for agricultural products.[6] The Korea-Chile FTA generally resorts to the WTO Agreements for its safeguard mechanism. Chapter 6 stipulates that both parties maintain WTO rights and obligations concerning safeguard matters. Safeguard actions would be dealt with exclusively by the WTO dispute settlement system. Notwithstanding Chapter 6, Article 3.12 sets forth a special safeguard system for agricultural goods in case an import increase causes or threatens to cause serious injury or "market disturbance".[7] This special agricultural safeguard provision substantially differs from the special safeguard mechanism under the WTO Agriculture Agreement that employs an automatic triggering system. Moreover, although 'material injury' and 'threat of material injury' are defined in line with the WTO Safeguard Agreement, the concept of 'market disturbance' is not specifically stipulated and completely unprecedented. The lack of clear definition on the latter element for safeguard actions in the Korean statutory system may lead to serious controversy in actual application of the provisions in a near future, unless it is elaborated with more specific guidelines or criteria.[8]

The exclusion of FTA parties from the WTO safeguard action, first adopted in the NAFTA, has also been discussed and will soon appear in the formal text of the FTA involving Korea. The FTA negotiation with India at the conclusion stage will include the first case of NAFTA style safeguard exception clauses. Such clause is very likely to be adopted in the KORUS FTA

The Korea-Singapore FTA adopted additional commitments for the anti-dumping mechanism: prohibition of zeroing and the "lesser duty" rule. Article 6.2 of the Korea-Singapore FTA stipulates that:

> 3. Notwithstanding paragraph 1, the Parties shall observe the following practices in anti-dumping cases between them in order to enhance transparency in the implementation of the WTO Anti-dumping Agreement:
>
> (a) when anti-dumping margins are established on the weighted average basis, all individual margins, whether positive or negative, should be counted toward the average; and
> (b) if a decision is taken to impose an anti-dumping duty pursuant to Article 9.1 of the WTO Agreement on Anti-dumping, the Party taking such a decision, should apply the 'lesser duty' rule, by imposing a duty which is less than the dumping

margin where such lesser duty would be adequate to remove the injury to the domestic industry.

The above provisions are noteworthy in that they are the first kind of a modified FTA trade remedy system adopted in the East Asia.

While the Korea-EFTA FTA retains basically all the rights and obligations under the WTO Anti-dumping Agreement, it also adopted the above mentioned a "lesser duty" rule. In addition, the Korea-EFTA FTA stipulates that parties "shall endeavor to refrain from initiating anti-dumping procedures against each other" and consult "with the other with a view to finding mutually acceptable solution", although it does not mandate any specific additional legal requirements. Interestingly, the parties under the Korea-EFTA FTA shall review whether there is need to maintain anti-dumping measures after five years of application. On the other hand, the Korea-EFTA FTA requires at least a 30 day period for mutual consultation before parties initiate countervailing investigations.

3) Special treatment for "internal trade" between Korea and North Korea

Currently, Korea is treating products from North Korea basically as domestic products and does not impose any tariff or other trade measures applicable to importation. In fact, Korea enacted a special implementation law for WTO Agreements in 1995 and declared that it would treat North Korean products as domestic goods. Article 5 of the "Special Law on Implementation of World Trade Organization Agreement", subtitled "Intra-Nation Transaction", provides that "the trade between South and North Koreas constitutes an internal trading within an economy and as such shall not be regarded as that between countries".[9] Notwithstanding this domestic regulation, the exemption of tariffs and other trade measures may invoke most-favored nation (MFN) treatment problems under the WTO system since North Korea appears to satisfy all the legal requirements to be treated as "independent customs territory".[10]

As transaction between Korea and North Korea grows especially using Gaesung Industrial Complex, special North Korean district where Korean companies manufacture products for consumption or further processing in Korea, a counterpart for Korea's FTA negotiation has raised a issue whether those products should be benefited under the FTA arrangement. The Korea-Singapore FTA first made a formal recognition of "internal" trade between South and North Koreas. But, transaction between South and North Koreas was not categorically recognized as "internal" trade. Instead, the following "outward processing" provision articulates the specific conditions carefully designed to embrace products from Gaesung Industrial Complex to render preferential treatment:

ARTICLE 4.4 : OUTWARD PROCESSING

1. Notwithstanding the relevant provisions of Article 4.2 and the product-specific requirements set out in Annex 4A, a good listed in Annex 4C shall be considered as originating even if it has undergone processes of production or operation outside the territory of a Party on a material exported from the Party and subsequently re-imported to the Party, provided that:

(a) the total value of non-originating inputs as set out in paragraph 2 does not exceed forty (40) per cent of the customs value of the final good for which originating status is claimed;
(b) the value of originating materials is not less than forty-five (45) per cent of the customs value of the final good for which originating status is claimed;
(c) the materials exported from a Party shall have been wholly obtained or produced in the Party or have undergone there processes of production or operation going beyond the non-qualifying operations in Article 4.16, prior to being exported outside the territory of the Party;
(d) the producer of the exported material and the producer of the final good for which originating status is claimed are the same;
(e) the re-imported good has been obtained through the processes of production or operation of the exported material; and
(f) the last process of production or operation[4-1] takes place in the territory of the Party.

2. For the purposes of paragraph 1(a), the total value of non-originating inputs shall be the value of any non-originating materials added in a Party as well as the value of any materials added and all other costs accumulated outside the territory of the Party, including transportation cost.

[4-1] The last process of production or operation does not exclude the non-qualifying operations stipulated in Article 4.16.

Goods listed in Annex 4C include plastics and articles thereof (HS Code Chapter 39), nuclear reactors, boilers, machinery and mechanical appliances; parts thereof (Chapter 84), electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles (Chapter 85), ships, boats and floating structures (Chapter 89), optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof (Chapter 90).

This provision was similarly adopted in the Korea-EFTA FTA. Annex I of the Korea-EFTA FTA has the provision regarding the exemption for territoriality principle as follows:

APPENDIX 4 TO ANNEX I
EXEMPTIONS FROM THE PRINCIPLE OF TERRITORIALITY

1. In accordance with Article 13 of Annex I, the acquisition of originating status shall not be affected by working or processing carried out outside the territory of a Party on materials exported from the Party concerned and subsequently re-imported to that Party, provided that:
(a) the total added value as set out in paragraph 5(a) does not exceed 10 percent of the ex-works price of the final product for which originating status is claimed; and

(b) the materials exported from the Party concerned shall be wholly obtained in that Party or having undergone working or processing going beyond the insufficient operations listed in Article 6 prior to being exported outside the territory of that Party.

2. Notwithstanding paragraph 1, for products listed in the Table set out at the end of this Appendix, the acquisition of originating status shall not be affected by working or processing carried out in an area, for instance an industrial zone, outside the territory of a Party, on materials exported from the Party concerned and subsequently re-imported to that Party, provided that:

(a) the total value of non-originating input as set out in paragraph 5(b) does not exceed 40 per cent of the ex-works price of the final product for which originating status is claimed; and

(b) the value of originating materials exported from the Party concerned is not less than 60 per cent of the total value of materials used in manufacturing the re-imported material or product.

The product coverage under the above provision was expanded from that of the Korea-Singapore FTA by including, *inter alia*, rubber products, articles of leather; apparel and clothing accessories, footwear, glass and glassware, precious metals, articles of iron or steel, vehicles other than railway or tramway rolling-stock, miscellaneous manufactured articles.

Although the above approach to treat products from North Korean territories was accepted by Singapore and EFTA, other FTA negotiation partners such as Japan and the United States have vehemently opposed to the adoption of similar provisions. It remains to be seen whether transaction between South and North Koreas can be recognized, directly or indirectly, as "internal trade" by other WTO Members in the future.

3. Assessment

The Korean government portrayed the purpose of its FTA policy not only as securing stable foreign markets but also as improving overall national competitiveness by introducing global standards to more segments of the economy. However, the FTA negotiations of the Korean government so far have not shown much promising prospect in that regard. Most of all, in contrast to the vision or the mandate of the FTA policy, the Korean government has not been able to accomplish substantial market liberalization. Considering the experience of the Korea-Japan FTA and KORUS FTA, the Korean government has been very defensive in market access negotiation and not been able to sufficiently liberalize the market to facilitate structural adjustment in industry sectors, especially services sector. Indeed, the foremost important reason to launch the KORUS FTA, at least by the Korean President, was to improve competitiveness of services sector by introducing advanced services from the US suppliers. Despite such an unprecedented level of political commitment, the Korean government could not seriously engage in services market negotiation.

This situation raises a structural problem for FTA negotiation. The primary FTA partners for

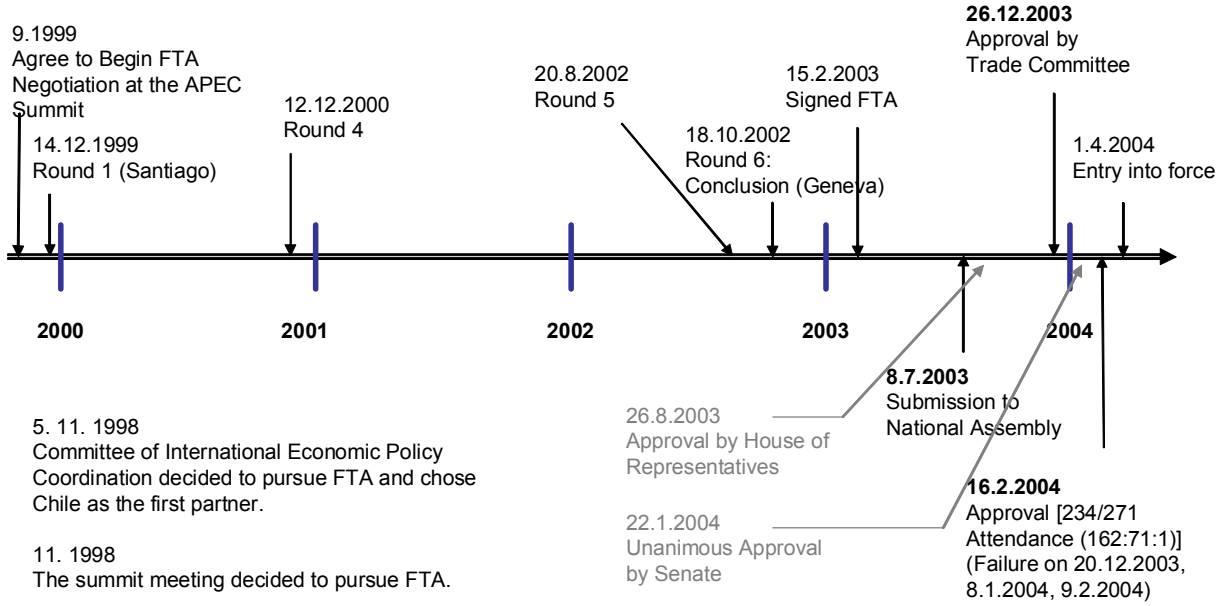
Korea such as the United States, Japan, the European Union and Canada typically have very low level of tariffs, particularly in manufacturing sectors which seem to be the major area for market access by the Korean products. Thus, tariff reduction negotiation for market access would not bring about substantial benefits for Korea. It is why the Korean government focuses more on services market liberalization for the key gain of the FTA with developed countries particularly because the recent economic growth in Korea has been seriously constrained by relative weakness in productivity and competitiveness in services sectors. However, the actual FTA negotiation does not embrace much services market liberalization and thereby the prospect of achieving the goal to initiate FTA negotiations becomes dimmer. Despite the urgent need to liberalize and consequently improve competitiveness of domestic services industries, this sector is typically seen as defensive industries once FTA negotiations with developed countries begin. So, the Korean government becomes very reluctant to liberalize services sectors so as to "protect weak domestic industries" or "not to lose trade negotiation battles", although a rational economic policy decision would require even voluntary liberalization.

The controversy relating to the KORUS FTA led the Korean government to establish a considerably developed FTA negotiation system. While the actual FTA negotiation with the US delegation is conducted mostly by the Ministry of Foreign Affairs and Trade, "The Presidential Committee on the KORUS FTA" was also established to address domestic conflicts among interest groups and industries.[11] In addition, apart from the "Unification, Foreign Affairs and Trade Committee" that has the primary responsibility on trade matters, the National Assembly constituted a "Special Committee on the KORUS FTA" to monitor the progress of the FTA negotiation and facilitate the cooperation with the government throughout the negotiation.[12] This development set an important model for future trade policies of the Korean government. But it is premature to conclude that these institutional developments actually contributed to domestic conflict resolution and rational conclusion of the FTA negotiation.

The due process aspects of FTA policies should also be improved to enhance legitimacy of policy implementation. Indeed, the Korea-Japan FTA negotiation was progressed with probably the most meticulous procedural due process. Regardless of strategic considerations in terms of FTA negotiation, it is disappointing to suddenly suspend the Korea-Japan FTA negotiation without more legitimate and democratic explanation by the Korean government to domestic constituencies or economic stake-holders.

The Korean government has a wide variety of experience in GATT/WTO system, but not much on FTA negotiation. Whereas the Korean government takes advantage of abundant FTA experience of other countries, it also has numerous problems to cope with unprecedented political as well as economical situations as a very late participant in the FTA race. The experience so far already seems to indicate that the multilateral trading system is more beneficial than bilateral trading system for the Korean economy and the Korean government.

APPENDIX 1: Procedural History of Korea-Chile FTA



APPENDIX 2: Comparison of Two Major Korean FTA Negotiations

	Korea-Japan FTA	Korea-US FTA
Framework Aspects		
Nature	Private sector driven (bottom-up case)	Government sector driven (top-down case)
Negotiating Position	Korea in a receiving side (Japan more aggressive)	Korea in a proposing side (US less enthusiastic)
Procedural Due Process	Procedural legitimacy (Joint study report and numerous public hearings)	Procedural problem (No joint study process and public hearing)
Time	Two years (1 year proposed by Japan)	Less than one year under the TPA constraint
Economic Background	Huge chronic trade deficit	Traditional major source of trade surplus
Characteristics	Almost purely economical FTA	Politically as well as economically loaded
Substantial Aspects		
Agricultural Trade	Surplus in both agricultural and fishery products	Deficit (rice import)
Investment	Aggressively attracting (BIT already established)	Not actively inducing (No BIT)
Trade Conflicts	None (in the middle of negotiation, one WTO case raised by Korea)	Many WTO disputes
Trade Remedy	Rarely used	Major target and user relation
Focus of Concession	Manufacturing sector	Services sector

[1] As of September 2006, Mongolia is the only WTO Member without any FTA arrangement.
[2] KREI and KIEP, White Paper on the Korea-Chile FTA, 83 (2004).
[3] WTO, WT/TPR/G/73 (dated 28 August 2000), para.67.
[4] The Korean government announced a comprehensive farming support program in an amount of more than $100 billion. Although the whole amount of $100 billion would not be provided as lump sum payment to farming sectors, it still included massive subsidy programs.
[5] Before dealing with Korea for FTA, Chile had FTA relationship with EC, the US, Mexico, Canada, Costa Rica and El Salvador.
[6] For more general discussion on FTA trade remedy systems, see Dukgeun Ahn, "Trade Remedy Systems for East Asian FTAs" in The WTO in the Twenty-First Century: Dispute Settlement, Negotiations and Regionalism in Asia (Yasuhei Taniguchi, Alan Yanovich and Jan Bohanes eds., Cambridge University Press, 2007).
[7] Laws on Investigation of Unfair Trade and Safeguard, Article 22.3 (Public Law 7093, promulgated on 20 January 2004).
[8] Article 22.3 of the Law on Investigation of Unfair Trade and Safeguard was elaborated by Article 22.3 of the Implementing Regulation (Presidential Order 18565, promulgated and entered into force on 21 October 2004). But, the Implementing Regulation did not clarify the concept of "market disturbance" either.
[9] Public Law No. 4858. See also Moon-soo Chung, "Implementation of the Results of the Uruguay Round Agreements: Korea" in *Implementing the Uruguay Round* (eds. by John Jackson and Alan Sykes) 375 (1997).
[10] Dukgeun Ahn, "Legal Issues for Korea's 'Internal Trade' in the WTO System", in *Multilateral and Regional Frameworks for Globalization: WTO and Free Trade Agreements* (eds. by Lim and Torrens, 2005).
[11] This special committee was established on 11 August 2006 with 14 committee members: six government officials and eight private sector representatives. The chairman is Dr Duksoo Han, former Deputy Prime Minister (or Minister of Finance and Economy).
[12] This committee was consisted of 20 congressmen, 10 from the ruling party (Uri Party), eight from the major opposing party (Hannara Party), one from Democratic Party and one from Democratic Labor Party. It is supposed to work for the period of 30 June 2006 to 30 June 2007.

Regional Trading Arrangements/ Free Trade Areas - Developments

Written by

M. Supperamaniam

Former Ambassador/Permanent Representative of Malaysia to the WTO

1. The emergence of Regional Trading Arrangements (RTAs) and the Free Trade Areas (FTAs) continues to attract attention in view of moves by countries in particular regions to establish regional groupings and bilateral pacts to enhance their mutual interests. Various political, economic and security based reasons are responsible for the recent surge in regional trading arrangement (RTAs) and Free Trade Areas (FTAs).

2. To date some 300 RTAs/FTAs have been notified to the WTO but only about 250 are currently in force. The number is expected to increase to 300 by 2007 if another 60 RTAs/FTAs currently under negotiations and 30 at the proposal stage are concluded. Many countries now belong to one or more typically, two or three RTAs/FTAs resulting in a "spaghetti bowl" of trade relationship.

3. The proliferation of RTAs/FTAs has resulted in a situation whereby intra-RTA trade accounted for about 40 percent of world trade in 2000 and is envisaged to constitute over 50 percent in 2005.

Changing Landscape of RTAs/FTAs

4. In recent years the growth, expansion and deepening of regional trade arrangement has been remarkable. Asian Pacific countries only recently joined the trend and there exists now an unprecedented amount of negotiating activity within the region. Countries like Singapore, India, Japan, Korea and China that have favoured the multilateral approach to trade liberalization have now chosen to pursue regional and bilateral arrangements with the

view to carve out their sphere of influence with distinct political and economic strategies.

5. The United States and to some extent the European Community have also given more attention to concluding different composition of RTAs/FTAs involving the widening of country coverage beyond the traditional regional zone. For example, RTAs/FTAs have emerged between countries and entities in different regions/continents (e.g. EU-Mexico, EU-Africa, US-Israel, US-Jordan, US-Morocco and US-Chile). In most cases these agreements are bilateral in membership, concluded by two countries/entities including in the case of free trade agreements negotiated and concluded by the two distinct RTAs (e.g. EU-MERCOSUR).

6. Developing countries are also actively participating in RTAs/FTAs with both developed (North-South) and developing countries (South-South).

7. In Asia, several RTAs are in force AFTA, SAARC and ECO in continental Asia and PICTA/PACER in the Pacific. SAARC has recently agreed transforming the entity into the South ASEAN Free Trade Area (SAFTA), while ECO has established the ECO Trade Agreement (ECOTA). The BIMSTEC Free Trade Agreement comprises countries such as Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal. APFTA is a preferential trade agreement that included India, Republic of Korea, China, Bangladesh, Sri Lanka and Lao Peoples Democratic Republic. This Agreement has the potential for strengthening inter-regional trading ties within Asia and the Pacific.

8. In addition to the regional arrangements, several of these countries have also concluded negotiations for FTAs on a bilateral basis. These included Singapore-Japan, Singapore-New Zealand, Thailand-China, Thailand-India, Singapore-India, India-Sri Lanka and Malaysia-Japan.

9. The qualitative dimension of RTAs in respect of coverage of policy areas has also evolved. RTAs/FTAs have traditionally been confined to trade in goods. However, after the establishment of the WTO, trade in services has also been included in many RTAs/FTAs. Recent new generation RTAs/FTAs increasingly cover not only trade in goods but also their 'behind the border' regulatory areas including trade in services investment, competition policy, intellectual property rights, government procurement, labour, environment and development cooperation.

10. In general the RTAs in Asia Pacific are more loosely institutionalised than those in Europe, Latin America and North America. In particular there are no customs unions in the Asian and Pacific region.

Malaysia's Free Trade Area Initiatives

11. Malaysia is an open economy, dependent on external trade for its economic growth. Malaysia's global trade is more than 180% of its GDP, reflecting the significance of external trade relations. Currently Malaysia ranks as the 18th largest trading economy in the world.

12. Hence Malaysia's trade policy objectives are aimed at maintaining an open and favourable global trading environment to further enhance Malaysia's economic growth and prosperity.

13. Malaysia formulates trade policies not just on a multilateral basis, but also on both regional and bilateral levels. On the multilateral front, Malaysia continues to assume a proactive role in the negotiations and work programme of the WTO with the view to contribute to the maintenance of open and strong rules based multilateral trading system. Concurrently, Malaysia is also engaged in efforts to negotiate free trade agreements with important trading partners on a bilateral and ASEAN basis. Bilateral trade and regional trading deals have emerged as an attractive strategy complementary to multilateralism.

Rationale and Approach to FTA Initiatives

14. Malaysian government's strong interest in FTAs has been spurred by the slow and uncertain progress in global trade negotiations under the WTO as well as to meet the increasing competition posed by her competitors who have already concluded or are negotiating bilaterally with major trading nations which are also Malaysia's important markets. Further, it has been recognized that such agreements offer scope for wider areas of economic and technical cooperation and prove to be effective conduits for linking trade and development goals of the countries involved.

15. Malaysia's objectives in FTA negotiations are to:

- seek better market access for goods and services;
- facilitate and promote trade, investment and economic development;
- enhance the competitiveness of Malaysian exporters; and
- build capacity in specific targeted areas through technical cooperation and collaboration.

16. In negotiating FTAs Malaysia is committed to the provisions of WTO. Its FTAs therefore cover substantially all trade, elimination of tariffs and do not raise trade barriers against non FTA partners.

17. Bilaterally, Malaysia has concluded an Economic Partnership Agreement (EPA) with Japan and is currently negotiating with Pakistan, Australia, New Zealand and the United States.

18. A Joint Study Group was established to undertake a feasibility study on a Malaysia-Chile FTA. On 17 November, on the margins of the APEC Summit in Ha Noi, both Malaysia and Chile officially announced their decision to initiate negotiation for a Malaysia/Chile FTA. Chile is the third largest trading partner in Latin America. The coverage of the FTA will be comprehensive, involving liberalisation of bilateral trade in goods and services and investment. The FTA if concluded has the potential to increase trade investment and economic ties between Malaysia and Chile. The Agreement would also make Chile a gateway for Malaysia's exports to South America, which has a population of 550m and imports US$298 billion worth of goods.

19. In January 2005, Malaysia and India agreed to conduct a joint feasibility study for a Malaysia-India Comprehensive Economic Cooperation Agreement (CECA). The Joint Study Group has completed the study and the report is currently being finalised. Based on the findings of the study, there are strong justifications for both countries to negotiate a CECA.

20. At the regional level, Malaysia is actively involved in ASEAN's initiatives to establish FTAs with its Dialogue Partners with the aim of promoting trade and investment flows and strengthening economic cooperation. In this regard, ASEAN is currently negotiating FTA with China, Korea, India, Japan, Australia and New Zealand.

Progress Made on Bilateral FTA Initiatives

21. **Malaysia-Japan**

- Malaysia concluded its first bilateral FTA with the signing of the Japan-Malaysia Economic Partnership Agreement (JMEPA) in Kuala Lumpur on 13 December 2005. JMEPA entered into force in July 2006.

- It is aimed at strengthening economic and industrial cooperation and enhancing and strengthening long-term bilateral trade and investment relations between the two economies. The FTA will be implemented over a 10-year period to enable domestic industries to adjust to gradual increase in competition.

- Under goods, Malaysia and Japan are both committed to reduce/eliminate import duties progressively on substantially all agricultural and industrial products over a 10-year period.

- Under the arrangement, Malaysia has agreed to eliminate import duties on rubber products, food products, plastics, paper and downstream iron products over six to eight years. With respect to chemicals and petrochemicals, iron and steel, paper products, and automotive parts and components, elimination of import duties will be effected over a period of 10 years.

- Japan on its part has agreed to maintain duty free treatment on 6,613 industrial products, tropical fruits and forestry products, and reduce and eliminate duties on fishery products, rubber and leather footwear, and cocoa products over 8 years.

- In the area of trade in services, both economies have agreed to accord improved market access compared to commitments under the WTO in selected sectors. The sectors are business and professional services, computer and related services, communication services, education services, tourism and related services, and health related services.

- In the area of investment, the agreement provides for the expansion and facilitation of freer cross-border investment between the two economies. These include commitments under liberalisation and protection of investment, and facilitation and promotion of

cross border investment flows.

- JMEPA also includes cooperation activities to further enhance Malaysia's capacity in selected sectors. Japan will assist Malaysia in developing the automotive sector, including the automotive parts industry. Projects involving capacity building in the automotive sector include Automotive Technical Expert Assistance Programme; Mould and Die Center in Malaysia; Vehicle Type Approval; Automotive Skill Training Centre in Malaysia; Automotive Skill Training Programme in Japan; Components and Parts Testing Center in Malaysia; Automotive Business Development Programme; Export Promotion; and Consultation on Joint Venture arrangements.

- Cooperation projects in other areas include development of Mutual Recognition Arrangements on testing and conformity assessment procedures, as well as cooperation, technical assistance and exchange of information on sanitary and phytosanitary measures imposed on agricultural products. These initiatives are expected to reduce costs and improve market access for exports from Malaysia to Japan. The other specific areas where cooperation is expected to intensify include education and human resource development and small and medium industries development.

22. **Malaysia-Pakistan FTA**

- Malaysia and Pakistan began negotiations on a Free Trade Agreement in April 2005.

- An Early Harvest Programme (EHP) was implemented beginning 1 January 2006. Under the EHP, Malaysia has offered 114 products (covering yarn, clothing and textile products) and Pakistan has offered 125 products (covering electrical appliances and machinery, plastics products, chemical products, rubber and timber products). Tariffs on these products have been reduced to 0-5 per cent.

- The FTA negotiations with Pakistan are comprehensive and cover liberalisation of goods and services, investment and cooperation activities. The agreement is expected to be concluded for implementation in early 2007.

23. **Malaysia-Australia/Malaysia-New Zealand**

- Currently Malaysia is negotiating with Australia and New Zealand separately for a comprehensive FTA covering liberalisation of trade in goods, services and investment, and cooperation activities.

24. **Malaysia-US**

- Malaysia and the US jointly announced the commencement of formal FTA negotiations on 8 March 2006 in Capitol Hill, Washington DC. Three rounds of negotiations have been held so far. Two more formal sessions have been scheduled to complete negotiations before the expiry of the Trade Promotion Authority on 1 July 2007.

- Several Working groups have been established to handle negotiations covering a range of issues including trade in goods, services, investment, government

procurement, e-commerce, environment, competition policy, intellectual property rights and technical barriers to trade.

Progress Made on ASEAN FTA Initiatives

25. **ASEAN-China**

- Under the Early Harvest Programme (EHP) implemented since 1 January 2004, all tariffs on EHP products have been fully eliminated on 1 January 2006 for ASEAN-6 and by 2010 for CLMV countries, namely Cambodia, Laos, Myanmar and Viet Nam.

- The EHP consists of several unprocessed agriculture products and specific manufactured products agreed between individual ASEAN countries and China.

- Malaysia's EHP list comprises 590 products, of which 503 are unprocessed agriculture products and 87 are specific manufactured products.

- Trade in Goods (TIG) Agreement was implemented on 20 July 2005.

- Agreement on Trade in Services and Investment being negotiated and scheduled for completion in 2006.

26. **ASEAN-Korea FTA**

- The Framework Agreement and the Agreement on Trade in Goods has been signed during the ASEAN Summit in Kuala Lumpur, 12-13 December 2005. The Agreement in Goods is expected to come into force in early 2007.

- Under this agreement, tariffs for Normal Track items are scheduled to be eliminated by 2010, with flexibility not exceeding 5% of all then tariff lines or as listed in an agreed schedule eliminated by 2012

- ASEAN and Korea are expected to complete negotiations on investment and services in 2006.

27. **ASEAN-India**

- The Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India was signed in October 2003. The Agreement provides for the establishment of an FTA in Goods for ASEAN and India by 2011 and 2016 for the Philippines and Cambodia, Laos, Myanmar and Viet Nam; and progressive liberalisation for trade in services and investments regimes. ASEAN and India are currently negotiating the modalities for tariff reduction/elimination.

28. **ASEAN-Japan FTA**

- The Framework for Comprehensive Economic Partnership (CEP) between ASEAN and Japan was signed on 8 October 2003 in Bali, Indonesia. The CEP provides for liberalisation of trade in goods, services and investment by 2012; facilitation and promotion of trade; and implementation of economic cooperation activities.

- ASEAN and Japan are continuing discussion on the elements in the CEP, including scope, structure and linkage between bilateral FTAs and the ASEAN-Japan CEP.

29. **ASEAN-Australia and New Zealand**

- ASEAN-Australia and New Zealand have initiated discussions towards finalisation of the Agreement on FTA by end-2006. Negotiations have commenced in the areas of goods, rules of origin, investment, services, cooperation activities and legal and institutional issues.

30. **ASEAN-EU**

- ASEAN-EU Vision Group that was established to enhance economic cooperation completed its study on the potential benefits of an FTA between the two regions. A formal announcement on the FTA would be made by the end of 2006.

Relationship between Regionalism and Multilateralism

31. The WTO system has several legal provisions that allow the establishment of RTAs/FTAs. GATT Article XXIV, Article V of GATS and the Enabling Clause provide for Customs Unions and Free Trade Areas subject to the criteria that restrictions are eliminated on "Substantially all the trade" among members and that the level of restrictions to outsiders is no higher than before. There are also certain restrictions stipulated in Article XXIV to ensure the grouping does not turn protectionist once it is formed. Both Articles XXIV and V reinforce the same criteria of intra-party trade liberalization, transparency and negligible effect on countries which are not members of the grouping.

32. However, the recent proliferations of RTAs/FTAs have raised concerns especially on the impact of RTAs on the multilateral trading system. There are differing view points on whether RTAs are stepping stones or potholes to the multilateral trading system. Some view regionalism and multilateralism as complementary, others see them as contradictory.

33. Proponents of RTAs have argued that RTAs promote quicker, freer and deeper integration with strong disciplines on trade related policies, act as laboratories of new disciplines and serve as an incubator of export expansion and diversification for developing countries. They believe regional initiatives gradually liberalize and serve as building blocks for freer global trade. RTAs are viewed as circles of free trade that expand until they finally converge. Under this scenario, in the long term, liberalisation at a regional level will eventually evolve towards global free trade.

34. Critics, on the other hand, have claimed that RTAs may prove to be inward looking, reduce

incentives for multilateral trade negotiations by enabling "forum shopping" and thereby run counter to multilateralism and fragmentize the global economy. They have argued that liberalisation at a regional level will lead in the long run to a world that is ultimately divided into a few major trade blocs.

35. This debate remains as yet unresolved due to both ambiguities in the theoretical literature as well as the lack of substantive empirical evidence that can be used to either support or refute either point of view.

Issues

36. The increasing trend towards the establishment of RTAs/FTAs, their disparate membership and varying coverage raises concerns as to how stable this mutually supportive accommodation between multilateralism and regionalism is.

37. Clearly, it raises a set of policy questions, in particular, in the context of parallel trade negotiations with overlapping agenda. Besides, some of the newer regional trading arrangements have straddled "north-south" boundaries and some have included issues not yet part of the multilateral trading system as well as complex rules of origin or preferential use of trade remedy laws.

38. In terms of implementation the proliferation of RTAs/FTAs has produced overlapping membership. A single country may end up with multiple trade rules that apply to different RTA membership giving rise to confusion to exporters and regulators. The broadening scope of RTAs, especially in policy areas that are not covered multilaterally may also increase the risk of inconsistencies in the rules and procedures among the RTAs themselves and between the RTAs and the multilateral framework. This will increase the transaction costs of trade, thereby reducing the incentives to trade. Complex rules of origin can only compound matters by reducing efficiency.

39. Consequently, there are growing fears that RTAs/FTAs could lead to the weakening of the WTO system and the emergence of a new system as an alternative to the WTO which is based on bilateralism/plurilateralism.

40. This is further compounded by the perception by many that the current WTO rules and disciplines do not seem adequate to effectively ensure that the new generation RTAs/FTAs will serve to enhance regional trade and contribute positively to multilateralism and strengthen global linkages.

41. Many of the legal problems surrounding the relationship between WTO rules and RTAs/FTAs are still unresolved and legal certainty is still lacking in this regard. Future panels and the Appellate Body may clarify some issues. However, the formation of rules through the dispute settlement mechanism is by its own nature piecemeal and lacks comprehensiveness.

42. Article XXIV, while permitting RTAs/FTAs is also intended to control their abuse. But the

Article has been eviscerated over the years through disuse and repeated abuse. It must be strengthened and more strictly enforced if it is to serve its role of permitting liberal RTAs/FTAs, while preventing protectionist trade blocs.

43. In this context, it is important that the WTO Committee on Regional Trade Agreements (CRTA) achieve substantive progress in resolving the major systemic and transparency issues concerning WTO rules on RTAs/FTAs. For example, WTO members must try to reach agreement on the interpretation of some of the terms and benchmarks in the provisions such as "substantially all the trade", "not on the whole higher or more restrictive", other regulations of commerce," "other restrictive regulations of commerce". This will help promote procedural clarity and legal certainty.

44. In addition an effective surveillance mechanism needs to be developed to ensure that RTAs/FTAs are in line with the multilateral trading system and complementary with WTO objectives. To promote the 'systemic convergence' between regionalism and multilateralism, the emergence of regional groupings and strengthening of the existing ones must be geared towards the maintenance and support of the multilateral trading system.

Conclusion

45. To sum up, RTAs/FTAs have important implications for the multilateral trading system. To ensure the positive interface between regionalism and multilateralism WTO members (the very governments that create FTAs) must truly commit themselves to freeing trade multilaterally. The success of the Doha Multilateral negotiations therefore remains a must.

46. So far many aspects of recent RTAs/FTAs – the rules of origin, labour, environment, intellectual properly rights, competition policy and investment provisions suggest that less wholesome motives are shaping their policies. If freer trade is to become more than fashionable talk, then WTO members must be committed to view the benefits of regional dynamism within the context of global approach to trade and investment.

47. From a developing country perspective, RTAs/FTAs have important implications for trade and development prospects. The challenge facing developing countries especially in relation to North-South RTAs/FTAs is to design and implement appropriate, coordinated and strategic pacing and sequencing of liberalization and regulatory commitments in order to maximize development gains.

Chinese Taipei's FTA

Written by

Tu, Chaw-Hsia

Research Fellow
Chung-Hua Institution for Economic Research

Owing to the limitations imposed by external factors, Chinese Taipei has not signed any free trade agreements (FTAs) with APEC member economies. However, Chinese Taipei has entered into free trade agreements with some Central American countries, i.e., Panama, Guatemala and Nicaragua. As regional economic integration may have negative repercussions on non-member economies' external trade and the entry of direct foreign investment, Chinese Taipei has in the past contacted several East Asian trading partners to discuss issues related to the mutual opening of markets. However, these have not led to any positive results owing to the prevalence of external factors. In the last couple of years, economic integration in East Asia has proceeded at a rapid pace, especially following the suspension of the Doha round of negotiations. In the future, we may expect enhanced negotiations on regional trade. Chinese Taipei must enjoy the same opportunities for participation. The major goal of this article is to delineate Chinese Taipei's policies in relation to FTAs. By referring to previously signed FTAs, this paper will explain such issues as the degree of market openness, the major agenda items covered and the future outlook.

1. Evolution of Chinese Taipei's FTA Policies

Just like the majority of East Asian economies, Chinese Taipei has, in its process of economic development, benefited greatly from a liberalized multilateral trade system. External trade has always played a major role in economic growth. Although Chinese Taipei was not a signatory to the GATT/WTO before 2002, our trading policies fundamentally observed the regulations prescribed by this multilateral trade system through the continued maintenance of an open market and the granting of most favored nation status to the majority of our trading partners. This explains the high degree of openness that we have adopted. When viewed from the angle of the proportion of export and import volume to national income, the degree of openness rose

from 84.5%[1] in 1990 to 103% in 2003. In 2002, Chinese Taipei acceded to the WTO as the Independent Customs Territory of Taiwan, Penghu, Kinmen and Matsu. In response to demands from WTO members, Chinese Taipei further opened its market, such that by 2005, the degree of openness had further increased to 124%. As the proportion of our external trade volume to GNP continued to grow, and the fact that, relative to other countries, Chinese Taipei's degree of openness was high, while considering the close relationship between the continued increase in external trade and the maintenance of economic prosperity, Chinese Taipei adopted a major policy of promoting greater interaction through trade and economic activities with other member economies. Just as in the 1990s, with the emergence of the trend towards regional economic integration, Chinese Taipei did consider signing FTAs and attempted to seek targets for consultations. However, as Chinese Taipei was not yet a member of the WTO at that time, it was not possible to cite guarantees to its negotiation counterparts as to the observance of WTO duties. As a consequence, no negotiations leading to the signing of FTAs were completed.

Upon Chinese Taipei's WTO accession in January 2002, economic integration around the world, including in East Asia, was taking place with even more enthusiasm. Chinese Taipei once again tried to seek FTA negotiation partners, but only Central American countries with which it had diplomatic ties signed FTAs with Chinese Taipei. As of November 2006, FTAs that had started to take effect were those signed with Panama (January 2004) and Guatemala (July 2006). FTA negotiations with Nicaragua have just been completed and the agreement is expected to take effect in 2007. Ongoing FTA negotiations include those with Honduras, El Salvador and the Dominican Republic.

2. Contents of FTAs Signed by Chinese Taipei

The FTAs signed by Chinese Taipei cover three major areas: liberalization in the trade of commodities and services, trade facilitation and economic cooperation. In terms of trade liberalization, Chinese Taipei basically conforms to the provisions of the GATT's Article XXIV, which outlines the three principles of "substantially all trade, reasonable length of time, and not to raise barriers to the other trade partners." Table 1 shows the implementation periods and the percentages of tariff phase-out items in the three FTAs signed by Chinese Taipei. As Chinese Taipei has agreed to a 10-year transition period for its tariff phase-out, the ratio of exceptional items listed below is 2.5%. This is basically in conformity with relevant provisions in the GATT's Article XXIV.

Of the limited number of exceptional items, the majority are sensitive farm products and a small number of industrial goods, such as sedans, small cargo trucks and vehicle chassis. As to the original country of origin, this in principle mainly has to do with "changes in tariff classification." In case of demands regarding the "regional value content" (RVC), the usual demand is RVC>35%.

As to trade facilitation, the major issues include simplified customs procedures, testing and inspection, sanitary standards and the degree of authorization. The major issues in regard to economic cooperation include providing assistance for the development of small and medium-sized businesses, enhanced trade promotions, greater foreign inward investment, the improvement of industrial technology and development, the protection of intellectual property,

the opening of the service industry, and the promotion of greater openness in mutual tourism, etc. As for the liberalization of the service industry, the issues mainly include openness beyond the commitments made upon accession to the WTO in the shipping, financial services and commercial services industries.

TABLE 1: FTA Tariff Phase-Out Schedule Signed by Chinese Taipei (Unit：%)

Phase-Out Period	Chinese Taipei-Panama FTA				Chinese Taipei-Guatemala FTA				Chinese Taipei-Nicaragua FTA			
	Chinese Taipei		Panama		Chinese Taipei		Guatemala		Chinese Taipei		Nicaragua	
	Item	%	Item	%	Item	%	Item	%	Item	%	Item	%
Immediately	6,187	71.2	4,181	48.7	5,649	63.9	3,964	63.1	5,797	65.6	3,375	51.1
5 years	1,729	19.9	1,933	22.5	1,332	15.1	19	0.3	1,755	19.9	734	11.1
Cut by one half in 1st year, then reduce the rest to 0 over 4 years	—	—	—	—	—	—	—	—	2	0.02	—	—
10 years	532	6.1	2,042	23.8	1,218	13.8	149	2.4	808	9.1	—	—
15 years	—	—	—	—	413	4.7	376	6.0	241	2.7	1,804	27.3
Exclude	192	2.2	423	4.9	221	2.5	1,448	23.0	222	2.5	371	5.6
Reduced by 20%	—	—	—	—	—	—	269	4.3	—	—	—	—
0 tariff since 5th year	—	—	—	—	—	—	3	0.0	—	—	—	—
0 tariff since 10th year	—	—	—	—	—	—	9	0.1	—	—	—	—
0 tariff since 15th year	—	—	—	—	—	—	49	0.8	—	—	—	—
Tariff Quota	48	0.6	—	—	6	0.1	—	—	14	0.2	325	4.9
Total	8,688	100.0	8,579	100.0	8,839	100.0	6,286	100.0	8,839	100.0	6,609	100.0

Source: Compiled from the tariff schedules of respective FTAs

3. Future Challenges

The goal of participating in regional economic integration is basically to benefit from guarantees to the export market, increased mutual investment and economic cooperation. However, Chinese Taipei's FTA negotiation counterparts are Latin American countries, which are not Chinese Taipei's major trading partners. For this reason, there are limited possibilities in terms of promoting trade and investment. In the future, in the economic interests of Chinese Taipei and to avoid its being excluded from regional economic cooperation, we must clearly find ways of participating in economic integration with our major trading partners and neighboring countries. From a trade and investment viewpoint, the East Asian region and the United States should constitute the most important targets for our FTA negotiations in the future.

(1) Strengthening economic integration with East Asian countries

Since the mid-1980s, East Asia has been registering the most rapid economic growth around the world. The increased prosperity has continued to push East Asian imports to greater heights.

Chinese Taipei's import and export trade relationships with East Asian countries have been strengthened by the even more rapid growth of trade between them. The share of Chinese Taipei's exports to its East Asian trading partners (ASEAN6 + Japan + Korea + Hong Kong, China + China) increased from 28% in 1980 to 60% in 2005 (see Table 2). Such rapid growth of trade with these countries was especially driven by Chinese Taipei's marked increase in outward investment in the East Asian region. Mutual trade arising from such investments has led to tightly-knit trading relationships with East Asian countries that are characterized by enhanced industrial division of labor and cooperation. Up until 2005, Chinese Taipei's direct and indirect investments in East Asian countries had amounted to US$59 billion, which usually caused it to rank as the 3rd or 4th largest source of foreign direct investment in each economy. Any further integration in the future will necessarily contribute to the promotion of bilateral trade, an increased division of labor, and social welfare on a significant scale.

TABLE 2: Chinese Taipei's Exports to Major East Asian Trading Partners

(Units: US$ millions; %)

Trading Partner / Year	Total Exports	ASEAN(5)	Japan	Korea	Hong Kong, China	China	Share of Chinese Taipei's Exports
1980	19,810.6	1,564.0	2,173.4	266.5	1,550.6	–	28.0
1985	30,725.7	1,806.3	3,460.9	253.8	2,539.7	–	26.2
1990	67,214.4	6,788.1	8,337.7	1,212.8	8,556.2	–	37.0
1995	111,658.8	13,897.7	13,156.7	2,571.8	26,105.9	–	49.9
2000	148,320.6	16,399.1	16,599.4	3,907.8	31,336.3	4,217.5	48.8
2005	189,400.3	22,070.6	14,481.4	5,575.0	30,722.3	40,885.9	60.0

Source: Taiwan Statistical Data Book.

Let us take the Comprehensive Economic Partnership of East Asia (CEPEA) proposed by Japan in 2006 as an example. An analytical study[2] conducted by Tu, Chaw-Hsia (October 2006) using the Global Trade Analysis Project (GTAP) model probes into the economic benefits that Chinese Taipei can derive from participating in CEPEA and the possible repercussions of its exclusion from this form of regional integration. The study reveals that if Chinese Taipei were not to succeed in joining CEPEA, its GDP growth rate would be negatively affected on a relatively grave scale. By contrast, participation in CEPEA would benefit almost all of the members. The major reason for this is that Chinese Taipei has already forged a close relationship in terms of an industrial division of labor with East Asian countries such that any further integration would serve to make the East Asian industrial division of labor enjoy greater completeness and thus lead to more trade and opportunities for industrial cooperation. Moreover, it would help to avoid the negative impact of trade diversion in the East Asian region.

CEPEA was proposed in 2006 by Japan's Minister of Economy, Trade and Industry, Toshihiro Nikai, to include the 10 ASEAN member countries, China, Japan, Korea, India, Australia and New Zealand. Although at present this idea is still in the conceptual stage, trade liberalization and facilitation should be part of its coverage. In the above-mentioned study, the researcher used GTAP 6.0 to simulate and analyze the effects of CEPEA on the export trades and GDP of these

countries. The results are presented in Tables 3 and 4. Table 3 shows that if a free trade zone were formed by these 16 countries, with the resulting phase out of tariffs and the implementation of trade facilitation measures[3], the export and import volumes of all participating countries would grow by between US$900 million and US$54.4 billion. The global trade volume would increase by US$157.3 billion. Chinese Taipei, because it is not a member, would suffer an export and import decline of US$2.3-3.2 billion.

However, if Chinese Taipei were to participate in this form of East Asian economic integration, its export and import volume would increase by some US$7.7-8.5 billion. At the same time, the export volumes of almost all member economies would also enjoy higher growth, except for Korea and Singapore. In terms of the contribution of such an agreement to global export trade, it would result in a rise of 11.4%. This means that the inclusion of Chinese Taipei in this economic integration would not only lead to bigger trade volumes as a result of a larger number of countries abolishing tariffs and implementing trade facilitation, but it would also prevent trade diversion that would arise from excluding Chinese Taipei. Such a situation would be advantageous not just for Chinese Taipei but also for East Asian economic entities as a whole, since the relatively smaller growth of exports in Korea and Singapore would be rather small and trade diversion against Chinese Taipei would disappear with her participation in this economic integration. As the trade structures of Korea and Singapore are the most similar to that of Chinese Taipei, these two economies would be the most likely beneficiaries of trade diversion were Chinese Taipei to be excluded from participating in the integration.

TABLE 3: Import and Export Changes Expected Under CEPEA (Trade liberalization +Trade facilitation + Dynamic simulation)[4] (Unit: $US millions)

FTA / Economy	ASEAN+6(excl. Chinese Taipei)		ASEAN+7(incl. Chinese Taipei)	
	Change in Imports	Change in Exports	Change in Imports	Change in Exports
Chinese Taipei	-2,398	-3,126	7,767	8,564
Australia	9,645	10,037	9,812	10,210
New Zealand	807	909	821	922
China	52,901	55,447	58,018	60,584
Japan	36,257	37,723	36,586	37,998
Korea	17,924	18,513	17,742	18,205
Indonesia	4,736	6,031	4,850	6,137
Malaysia	5,213	7,373	5,355	7,472
Philippines	3,075	3,063	3,202	3,190
Singapore	5,819	5,300	5,481	4,953
Thailand	14,106	16,178	14,661	16,742
Viet Nam	4,729	4,616	5,481	5,276
India	13,863	15,270	14,253	15,672
Other Asia	1,180	1,264	1,279	1,363
US	-7,479	-7,240	-8,168	-7,999
Canada	-346	-537	-323	-526
Mexico	-158	-229	-87	-155
EU	-9,268	-12,705	-9,660	-13,403
Other World	6,508	-505	7,967	117
Total	157,114	157,382	175,037	175,322

Source: Tu Chaw-Hsia (2006), The Impact of the East Asian Economic Cooperation Agreement on Taiwan, CIER.

Table 4 illustrates the effects of East Asian regional integration both with and without the participation of Chinese Taipei. Viewed in terms of the impact of regional integration on the real GDPs of member economies, the static simulation shows that, with the participation of Chinese Taipei, the growth of real GDP of almost all member countries will be even higher, with the exception of Japan, which will remain unchanged, and Singapore, which will become slight decline. It is evident that the inclusion of Chinese Taipei in the economic integration of East Asia will be economically beneficial to the region as a whole. On the contrary, if Chinese Taipei were not to participate, the static simulation shows that there would be a drop in real GDP of 0.091%, or 0.773% when the dynamic simulation is carried out. The static simulation shows that Japan's real GDP will not be affected, while that of Singapore will experience a slight increase, as other member economies record lower real GDP growth rates. For this reason, both for Chinese Taipei and the vast majority of the East Asian economies, the inclusion of Chinese Taipei in CEPEA should be strongly encouraged.

TABLE 4: GDP Changes Expected Under CEPEA (Unit: %)

Rank	Areas	Real GDP				Nominal GDP			
		ASEAN+6 (excl. Chinese Taipei)		ASEAN+7 (incl. Chinese Taipei)		ASEAN+6 (excl. Chinese Taipei)		ASEAN+7 (incl. Chinese Taipei)	
		Trade liberalization +Trade facilitation + Dynamic simulation		Trade liberalization +Trade facilitation + Dynamic simulation		Trade liberalization +Trade facilitation + Dynamic simulation		Trade liberalization +Trade facilitation + Dynamic simulation	
		Static	Dynamic	Static	Dynamic	Static	Dynamic	Static	Dynamic
1	Chinese Taipei	-0.091	-0.772	0.156	0.940	-1.802	-2.228	2.102	2.587
2	Australia	0.213	1.690	0.215	1.709	6.956	7.460	7.019	7.549
3	New Zealand	0.132	1.199	0.132	1.224	2.754	3.423	2.779	3.476
4	China	0.134	0.529	0.190	0.596	0.576	0.769	0.489	0.661
6	Japan	0.097	0.064	0.097	0.062	1.328	1.131	1.356	1.156
7	Korea	1.509	0.636	1.513	0.579	2.181	0.588	1.967	0.341
8	Indonesia	0.095	2.661	0.106	2.677	2.565	4.631	2.517	4.596
9	Malaysia	0.938	2.960	0.957	2.972	2.316	3.810	2.246	3.740
10	Philippines	0.283	2.619	0.292	2.657	1.733	3.342	1.721	3.355
11	Singapore	0.074	2.530	0.064	2.388	4.787	6.256	4.513	5.949
12	Thailand	0.471	7.223	0.556	7.399	4.476	8.590	4.405	8.560
13	Viet Nam	1.297	3.546	1.709	4.633	3.832	3.444	4.839	4.665
14	India	0.393	-0.198	0.401	-0.157	-4.060	-5.086	-4.148	-5.138
15	Other Asia	0.060	1.796	0.079	1.794	-0.162	1.300	-0.352	1.102
16	US	-0.003	-0.043	-0.003	-0.049	-0.440	-0.276	-0.456	-0.281
17	Canada	-0.009	-0.023	-0.010	-0.027	-0.310	-0.184	-0.310	-0.175
18	Mexico	-0.009	-0.071	-0.011	-0.070	-0.268	-0.217	-0.242	-0.187
19	EU	-0.009	-0.029	-0.010	-0.034	-0.403	-0.224	-0.421	-0.229
20	Other World	-0.039	1.148	-0.040	1.316	-0.599	0.684	-0.626	0.828

Source: See Table3.

(2) Strengthening economic integration with the United States and other APEC members

The success of NAFTA has oriented the United State's policies towards bilateral or regional trade negotiations in the 21st century. Recently, the US has initiated FTA talks with Southeast Asian countries and Korea. In the future, when negotiations eventually lead to the formation of free trade areas, Chinese Taipei's products will experience more trade diversion pressure in the American market. Moreover, Chinese Taipei will increasingly fail to attract direct foreign investors. For these reasons, economic integration with the United States is an important goal in Chinese Taipei's efforts towards entering into FTAs. However, in order to have the US embark on FTA negotiations with Chinese Taipei, the trade and economic ties between the two sides of Taiwan Strait should be further improved for the sake of US business interests. However, strengthening the economic relationship with the United States should take place no more slowly than the improving of communication and economic ties with China based on the economic security concerns of Chinese Taipei. Thus, in order to strengthen economic integration with major trading partners, the question of whether or not cross-Strait relations should be improved is an issue that must be addressed.

As far as the economic relationship between Chinese Taipei and China is concerned, China is Chinese Taipei's most important export market. Furthermore, the inflow of foreign direct investment into China from Chinese Taipei has amounted to US$39.6 billion, which ranks it as the 4th largest source of investment in China, next to Hong Kong, China; the US; and Japan. Apparently there are many benefits to be reaped from the further liberalization of trade, increased division of labor, and additional opportunities for investment between them. In order to enhance economic cooperation between them and reap those benefits, they should accommodate each other first in both an economic and political sense.

In addition, the US government has recently expressed interest in again promoting the APEC Free Trade Agreement (FTAAP) in the APEC annual meeting. Currently, more than a hundred FTAs have been signed or are under negotiation between APEC members. FTAAP could prove to be a good opportunity for simplifying and integrating these divergent FTAs. Chinese Taipei must take the opportunity to speed up the improvement of its bi-coastal relations and participate in FTAAP to promote greater industrial division of labor and cooperation among Asia-Pacific member economies, and to further integrate the economic systems in this region.

[1] The degree of openness can be shown through the proportion of export and import trade in GDP. Here, the figure for the degree of openness has been calculated by dividing total import and export value by GNP. Therefore the degree of openness of Chinese Taipei's economy will be higher than 124% in 2005 if we calculate this figure in terms of GDP.

[2] Tu, Chaw-Hsia, "The Impact of the East Asian Economic Cooperation Agreement on Taiwan," Chung Hua Institution for Economic Research, October 2006.

[3] We assume that the trade facilitation measure will lead to a 5% saving in member countries' administrative and trading costs.

[4] Dynamic simulation refers to the addition of capital accumulation effects to static simulation.

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Thailand's Position towards FTAs

Written by

Lawan Thanadsillapakul

Professor of Law, Ph.D., LL.M.
Director, The Institute for International Economic and Business Law Studies
Sukhothai Thammatirat Open University

1. Introduction

In the past decades, it is clear that the global trading system has become much more liberalized and the world economies have become increasingly integrated. On the one hand, this is due to the successive rounds of trade negotiations under the auspices of the World Trade Organization (WTO), which have resulted in the progressive liberalization of both traditional and new sectors, such as trade in agriculture and services, as well as trade-related investment measures and intellectual property rights protection issues, on the other hand, to the establishment of regional trading arrangements and free trade agreements, or RTAs and FTAs.

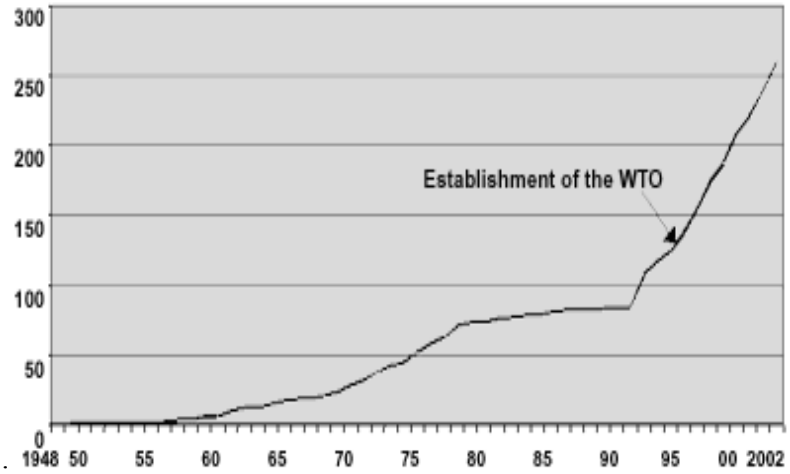
2. The surge of RTAs and FTAs

Since the latter half of the 1990s, due in part to the slowing down of the WTO trade liberalization processes, it is evident that there has been an exponential increase in the number of RTAs and FTAs in every part of the world. Especially, after the failure of WTO Meeting at the multilateral level in Cancun, Mexico, industrial countries including some developing countries have attempted to initiate free trade agreement to promote international trade and have pushed **some items**[1] in the agreement, which cannot be achieved at the multilateral level to be able to reach its goal at a bilateral and regional level. Thailand is no exception. Thailand is active in negotiating many FTAs with its economic/trading partners both at a regional[2] and bilateral[3] level. Thailand has already signed free trade agreements with China, India, Bahrain, Peru and Australia, and is in the process of negotiating with the US, Japan and other countries, especially the EU.

3. Global Trend of the creation of RTAs and FTAs

The surge of FTAs and RTAs has been seen in various parts of the world. In the Americas, the North America Free Trade Agreement, or NAFTA, was formed in 1994, and now 34 countries in that region are moving ahead with the creation of the Free Trade Area of the Americas, or FTAA. Likewise, at the beginning of 2004, we all saw the successful enlargement of the European Union from 15 to 25 countries. In the Asian region, China, Japan, Korea, and India have also begun a series of FTA negotiations with their major trading partners. Additionally, the ASEAN Free Trade Area, or AFTA has been implemented. Particularly, the launches of ASEAN Investment Area or AIA, the ASEAN Framework Agreement on Trade in Services or AFAS, and the new ASEAN Industrial Cooperation Scheme or AICO have been complementarily implemented along with the AFTA.[4] All of the ASEAN countries are now engaged in the process of establishing an FTA with China, India, and Japan. Not only has the initiation of RTAs and FTAs been implemented in Europe, America and Asia but also in Africa, Australia and Latin America. As a consequence, the WTO has reported that the numbers of these arrangements have already exceeded 300 by 2005,[5] of which up to 70 per cent will be in the form of bilateral FTAs.

CHART 1: Evolution of Regional Trade Agreements in the world, 1948-2002
Number of RTAs



Source: WTO Secretariat

4. Thailand and FTAs

As a strong supporter of free and fair trade, Thailand has been an active participant in the global trade liberalization process through the various regional and international fora, such as ASEAN, the Asia-Europe Meeting (ASEM), the Asia Pacific Economic Cooperation (APEC), the WTO, and is now in the process of developing free trade arrangements and closer economic cooperation with countries across the world.

Thailand has concluded an FTA with Australia at the end of 2004 and began to implement the Agreement on 1 January 2005. Thailand also signed an FTA Agreement with New Zealand in April 2005 so that both economies can become party to an FTA by 2010, the content of which is similar to the agreement with Australia. The Agreement with Peru was also signed so Thailand and Peru have started the implementation process. The first phase of the FTA Agreement with India, or the so called Early Harvest Agreement, in 82 products started on 1 September 2005, and Thailand is currently negotiating the details of the full FTA with India. Thailand and Bahrain are also FTA parties. Thailand is now working with Japan on free trade arrangements: the Japan-Thailand Economic Partnership (JTEP). Thailand has begun the FTA talks with the US in June 2004.[6] Furthermore, Thailand has signed Framework Agreements with the BIMSTEC countries so as to establish an FTA by 2015/17, and the formal consultations with EFTA had commenced by mid-2005. Most recently, ASEAN and EU have completed the feasibility study on the possibility of FTA negotiation between the two regions. It was expected that the start of the ASEAN-EU FTA negotiation would begin in March 2007.[7]

Moreover, apart from the establishment of AFTA, Thailand is now working closely with other ASEAN members, at a regional level, to establish a free trade area with its major trading partners, such as India, China, Japan, Korea, and the CER or Australia and New Zealand. The negotiations between ASEAN and each of these countries are expected to be concluded within 2 years in order to become full fledged FTAs by 2015 or at the latest 2020.[8]

5. The Initiation of FTAs in ASEAN with the US[9]

The United States is pursuing regional and bilateral trade initiatives that will reinforce the global efforts in trade and investment liberalization. In 2002, President Bush announced an important new trade initiative with the Association of Southeast Asian Nations (ASEAN)-the Enterprise for ASEAN Initiative (EAI). The United States believes that a strong US-ASEAN relationship is a force for stability and development in the Southeast Asian region. The EAI will enhance already close US ties with ASEAN.

The EAI offers the prospect of bilateral free trade agreements (FTAs) between the United States and ASEAN countries that are committed to economic reforms and openness. The goal is to create a network of bilateral FTAs, which will increase trade and investment, tying more closely together the US-ASEAN economies in the futures. The EAI initiative will encourage both bilateral and regional liberalization, and help APEC reach the Bogor goals for achieving free and open trade and investment in the Asia Pacific region.

6. The Enterprise for ASEAN Initiative (EAI): A Roadmap to FTAs

Under the EAI, the United States and individual ASEAN countries will jointly determine if and when they are ready to launch FTA negotiations. The EAI allows ASEAN countries the flexibility to move at their own speed toward an FTA with the United States. Therefore, the objective of the creation of the Enterprise for ASEAN Initiative (EAI) is to pave the way for

ASEAN member countries to be ready in FTA negotiations with the US. The process of FTA negotiation between the US and ASEAN countries would be based on the following strategies:

- *The United States would expect a potential FTA partner to be a member of the World Trade Organization (WTO), and to have concluded a Trade and Investment Framework Agreement (TIFA) with the US - thus laying the groundwork for future FTA negotiations.*
- *The United States will continue to support the efforts of the three ASEAN members (Cambodia, Laos, and Viet Nam) that do not yet belong to the WTO to complete their accessions successfully.*
- *The United States has TIFAs with Indonesia and the Philippines - and has signed one with Thailand.*
- *FTAs with ASEAN countries will be based on the high standards set in the US-Singapore FTA.*

7. The Enterprise for ASEAN Initiative

The Enterprise for ASEAN Initiative, which was announced in October 2002, is designed to strengthen the US economic ties with the ASEAN countries, which include Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam. With the two-way trade of nearly $120 billion annually, the 10-member ASEAN group already is the US' fifth largest trading partner collectively. The region represents about 500 million people with a combined gross domestic product of $737 billion.[10]

Under the EAI, the United States offered the prospect of bilateral free trade agreements with ASEAN countries that are committed to economic reforms and openness inherent in an FTA with the United States. Any potential FTA partner must be a WTO member and have a TIFA with the United States. The United States now has TIFAs with Indonesia, Philippines, Thailand, Brunei Darussalam and Malaysia. The United States' goal is to create a network of bilateral FTAs with ASEAN countries.

8. Trade and Investment Framework Agreements

A Trade and Investment Framework Agreement (TIFA) is a consultative mechanism for the United States to discuss issues affecting trade and investment with another country. TIFAs have been negotiated predominantly with countries that are in the beginning stages of opening up their economies to international trade and investment, either because they were traditionally isolated or had closed economies. In recent years, the United States has concluded many TIFAs including with the Central Asian countries: Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, Thailand, Brunei, Saudi Arabia, Algeria, Bahrain, Malaysia, Qatar, United Arab Emirates, Kuwait, Yemen, Pakistan, Afghanistan, Mongolia, Indonesia, The Philippines, Sri Lanka, Tunisia, Turkey, Nigeria, Ghana, South Africa, West Africa Economic and Monetary Union, Common Market for Eastern and Southern Africa (COMESA), and Oman.

Although TIFAs are non-binding, the US hopes that they can yield direct benefits by addressing specific trade problems and by helping trading partners develop the experience, institutions and rules[11] that advance integration into the global economy, creating momentum for liberalization that in some cases can lead to a Free Trade Agreement (FTA).

9. Free Trade Agreements

The United States pursues comprehensive free trade agreements with like-minded trading partners, to provide broad liberalization of trade relations in goods, services, intellectual property, investment and other areas. These regional and bilateral FTAs are intended to complement US global trade liberalization objectives and add momentum to the global drive for open markets. The agreements are consistent with World Trade Organization (WTO) rules and cover substantially all trade between the parties, so as to avoid distortions to global trade. But they allow like-minded partners to go beyond WTO requirements, the so called "GATT Plus", offering stronger protections for investors and intellectual property rights, for example, and incorporating obligations to uphold internationally recognized core labor standards and to protect the environment. All these mechanism have been facilitated by the passing of the Bipartisan Trade Promotion Authority Act.[12]

Since Congress gave the President Trade Promotion Authority (TPA) in 2002, the United States has embarked on an unprecedented program of free trade negotiations with selected trading partners. TPA is scheduled to expire on 30 June 2007 with a possibility of extension. Free Trade Agreements (FTAs) are in force with Israel (1985), Canada and Mexico through the North America Free Trade Agreement (NAFTA - 1993), Jordan (2000), Chile (2004), Singapore (2004), Australia (2005), Morocco (2006) and El Salvador, Honduras, and Nicaragua (2006) through the Central America-Dominican Republic Free Trade Agreement (CAFTA). As of April 2006, FTA negotiations had been concluded but were pending entry into force with Costa Rica, the Dominican Republic, Guatemala, Colombia, Peru, Oman, Bahrain. As of the same date, FTA negotiations were under way or planned with Ecuador, Panama, the United Arab Emirates, the Southern African Customs Union (SACU), Thailand, Korea, and Malaysia. Talks are also underway to conclude a Free Trade Area of the Americas (FTAA), covering the entire Western Hemisphere.

The foregoing initiatives provide ASEAN countries the opportunity and framework to conclude FTA with the US, and thus oblige ASEAN members to well prepare their economies and economic infrastructure as well as legal and institutional frameworks being ready for negotiating FTAs with the US.

10. FTA Potential Benefits and Costs for Thailand[13]

The basic reason that Thailand, like a majority of countries, has been actively engaged in these trade liberalization efforts is due to the simple fact that free trade enhances the opportunity for economic growth and development.

For instance, with the removal of tariffs and non-tariff measures and thus the creation of a more open trading environment, FTAs can greatly expand Thailand's trade and exports, and thus growth opportunities. Thai companies, especially those within the manufacturing sector, can also expand and diversify their resource and production base and therefore gain the economies of scale, boost their productivity, and obtain specialization in order to develop the economy. In this connection, the increased competitive level from the more open business environment can also help to ensure the better use and allocation of existing resources, as well as encourage the restructuring and reform process both in the private and public sectors so as to create a more favorable business environment. Similarly, an open trade policy can also effectively raise the attractiveness of a country to foreign direct investment, thereby helping to inject greater capital and know-how into the economy which are vital ingredients to improve efficiency and promote growth. Furthermore, with greater exchanges and better understanding through the creation of FTAs, Thailand will not only become better acquainted with partner countries which is the basis for a long-term partnership but also develop joint cooperation to raise international competitiveness and statue within the international trading fora.

However, this is not to say that there are no costs associated with freer trade. With the more open market, for example, Thailand is likely to be much more vulnerable to outside forces and global instabilities. With freer trade, Thai local companies will also encounter an increasing level of competition, which could result in the crowding out of less competitive firms and industries. And the political, social, and cultural repercussions of a more open environment could also be high. Nonetheless, it is clear these negative ramifications can be effectively dealt with through proper preparations, adjustments, reforms, and through joint efforts and intensified cooperation from all sides. More importantly, the lost of opportunities for not participating in this globalization and trade liberalization process can be extremely high; not only will Thailand's trade and market opportunities be severely limited, or even diminished, but Thailand will also be shutting itself out from an enormous pool of global resources and capital needed for development.

11. Thailand's FTA Negotiating Strategy

- FTA should be comprehensive in scope covering trade liberalization in goods, services, and investment, as well as the elimination of non-tariff barriers and cooperation to facilitate trade and development.
- FTA should be based on reciprocity by taking into account the distinct levels of economic development of each country; and flexibility, such as a longer liberalization period, should be granted to accommodate necessary adjustments.
- FTA should be consistent with WTO rules and conditions, which indicate that FTA must cover substantially all the trade in goods and services between the FTA partners.
- FTA should incorporate mechanisms to prevent/annul the negative effects on domestic industries, such as Anti-Dumping (AD) and Counter-vailing Duties (CVD) measures, Safeguards, and Dispute Settlement Mechanism (DSM)

12. FTA Preparations and Adjustments

In order to ensure that Thailand's national interests are protected and Thai people and businesses will fully benefit from the FTAs, Thailand has undertaken numerous steps and adopted several measures, which include the following:

- The establishment of FTA Working Groups consisting of the Negotiation Committee, which is made up of FTA Chief Negotiators, the Steering Committee on International Trade Negotiations, which consists of experts from the public and private sector to coordinate and serves as a think-tank on FTA matters, and the FTA Supporting Committee, which oversees the implementation, adjustment, and restructuring processes of the Thai economy.
- The reform and restructuring of the public sector so as to facilitate and lower the costs of trade and businesses, such as the reforms of tax and tariff structures, the simplification of customs procedures, and the expansion of finance and credit facilities.
- The development of infrastructures to facilitate trade, especially in the area of land, sea, and air transportation, as well as information and data to adjust to the new trade and market conditions.
- The strengthening small and medium enterprises (SMEs) and the grassroots economy through research and development, training, and marketing and skill development in order to raise the productivity, efficiency, and international competitiveness of Thai people, products, and economy.
- The promotion of trade and economic relationships between Thailand and FTA counterparts, such as through establishment of joint business councils, working committees, official visits, and trade fairs and exhibitions.
- The promotion of a modern, productive and innovative workforce through training and investment in knowledge, skill, and entrepreneurship development, and e-literacy.
- The establishment of social safety nets, such as job training and retraining, alternative skill development, the upgrading of the educational systems and facilities and a social and health care system.

13. Some Concerns on FTAs

The enforced free trade agreements that Thailand has, for example, with China and India at the moment take effect with the decrease in tariffs and the start of new markets. But if Thailand follows the FTA framework that the United States of America has with Singapore and Chile, it will not only allow free investment but also further expansion of intellectual property rights to life forms and culture to fall into commercial firms' hands as evidenced in the US free trade agreements with Singapore and Chile. Concerning this vital matter, free trade agreement would tremendously affect majority of the people such as agriculturists, consumers, retailers and others. More importantly, it leaves the problem in touching on the state sovereignty issue.[14]

As observed and as what appears to take place in the near future, the procedure of decision-making on free trade agreement has been centralized and proceeded by the government and powerful private interest groups which have close relations with the government. As a consequence, there is the tendency that the agreement would negatively have an impact on the

wide-ranged groups of people of the country.

On the grounds of the foregoing, Thai people, academic institutes and NGOs, including governmental institutes such as House of Parliament need to play their roles together in a study on the effects of Free Trade Agreement (FTA). In connection with this, it is also essential that the suggestions should be able to push the free trade agreement to genuinely benefit the majority of the population. The agreement should be inured domestically and should, at the same time, seek collaboration and international support.

14. Current FTAs and RTAs with Thailand

Currently, Thailand has and has negotiated the following FTAs:

Thailand - Australia CER-FTA
Thailand - Peru Free Trade Agreement
Thailand - New Zealand Closer Economic Partnership: CEP
Thailand - Bahrain Free Trade Agreement
Thailand - India Free Trade Agreement
ASEAN - China Free Trade Agreement, with Thailand a member of ASEAN
BIMST-EC (Bangladesh-India-Myanmar-Sri Lanka-Thailand Economic Cooperation)
European Free Trade Association: EFTA
Japan - Thailand Economic Partnership (JTEP)
Thailand - US Free Trade Agreement

15. Conclusion

There is no denying that Thailand, like many other countries, will encounter difficulties and obstacles as she proceeds with the restructuring and adjustment processes so as to keep pace with the rapid changes of the more open trading environment. But it is also clear that, with appropriate adjustments, there can be considerable gains both in terms of increasing resource base and expanding market opportunities and in terms of acquiring the needed technological know-how and expertise needed to further develop and prosper, provided that the FTA texts are fairly elaborated and mutually agreed based on the equal bargaining power.

This being the case, Thailand will continue to intensify all efforts so as to upgrade domestic resources and industries and prepare for the challenges ahead. Thailand will also remain fully committed to the strengthening of economic cooperation and partnership with all trading partners and actively participate in the international trading fora in order to create a free and fair global trading system. Indeed, it is through this dual track approach that Thailand can assure itself of continual growth and development and succeed in fast-tracking and securing Thailand's position within the global arena. The important concerns for FTAs and RTAs are the fair and equitable legal and institutional framework for implementing such economic agreements, especially the texts of the agreements and the negotiation process that need to be in conformity

with the Constitution and other procedure: the legitimacy of RTAs and FTAs negotiation.

Note:

- An Early Harvest (EH) Agreement is a partial FTA on groups of products which the FTA partners have agreed to liberalize first and continue with negotiations on the rest of their products.
- BIMSTEC or the Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation consist of Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.
- EFTA or European Free Trade Area consists of Norway, Switzerland, Iceland, and Liechtenstein.

MERCOSUR countries are Brazil, Argentina, Paraguay, Uruguay and Chile.

TABLE 1: Notification of the creation of RTAs under GATT/WTO (As of 1 March 2006)

NOTIFICATIONS OF RTAs IN FORCE TO GATT/WTO			
	Accessions	**New RTAs**	**Total**
GATT Art. XXIV (FTA)	4	120	**124**
GATT Art. XXIV (CU)	5	6	**11**
Enabling Clause	1	21	**22**
GATS Art. V	2	34	**36**
Total	**12**	**181**	**193**

EXAMINATION PROCESS				
Status / **WTO provision**	Enabling Clause	GATS Art. V	GATT Art. XXIV	**Grand Total**
Examination not requested	19	1	5	**25**
Factual examination not started	0	10	45	**55**
Under factual examination	1	11	24	**36**
Factual examination concluded	0	11	39	**50**
Consultations on draft report	0	3	4	**7**
Report adopted	2	0	18	**20**
Grand Total	**22**	**36**	**135**	**193**

Source: WTO Secretariat

[1] This can be clearly seen from the FTA texts proposed by the US, which is a FTA template based on the US FTA model, to its trading partners, especially the investment chapter, trade in service chapter and IP chapter.
[2] For example, Thailand is a member of ASEAN and APEC. In both regional organizations, there are many economic integration programs being launched to attaining the objectives of liberalization, e.g. the ASEAN Investment Area, the ASEAN Framework Agreement on Trade in Services, etc.
[3] See the current Thai FTAs partners.
[4] ASEAN Secretariat, also see Lawan Thanadsillapakul (2000) Open Regionalism in ASEAN. Washington D.C.: The World Bank.
[5] WTO Secretariat
[6] Thailand and the US have negotiated the FTA for six rounds starting in 2004, which have been taken place in Honolulu, Hawaii, USA for the first and second round, in Bangkok, Montana, Hawaii, and Chiengmai respectively for the 3rd to 6th rounds. The FTA negotiation was pending due to the coup d' etat in Thailand, and the Thai-US FTA negotiation was postponed until the Thai government will have a formal legitimate government.
[7] Thansetthakij, 5-7 October 2006.
[8] Department of Trade Negotiation, The Ministry of Commerce, Thailand.
[9] Based on the US State Secretary's report.
[10] See the US State Secretary's report.
[11] The new US FTA model has been designed to liberalize trade and investment, especially to protect the US investment and investor in a host country without host country's governmental intervention based on the mutual combination of the National Treatment and Most-Favored-Nation Treatment as well as to highly protect IP and environment. The New US FTA model is very similar to the MAI aiming at the establishment of a very high standard of rules and regulations. Also, the FTA texts seek for the investor- state dispute settlement mechanism through arbitration process.
[12] In passing the 2002 Bipartisan Trade Promotion Authority Act, Congress recognized that stable trading relationships promote security and prosperity and foster world peace by binding nations together through a series of mutual rights and obligations. FTAs also contribute to US economic strength by leveling the playing field for US businesses, spurring productivity and competitiveness, creating well-paying export-related jobs and providing more choices and better value for American consumers.
[13] Based on the report of the Department of Trade Negotiation, The Ministry of Commerce, Thailand.
[14] For instance, the negotiation process of FTA with the US and other countries cannot conform with the Thai Constitution due to the fact that all the FTA texts are of utmost confidentiality. Therefore, it cannot be investigated and studied by the public and related sector affected by the FTA.

Assessing the Prospects for a US-Japan FTA

Written by

Saadia M. Pekkanen*

Job and Gertrud Tamaki Professor, Jackson School of International Studies
Adjunct Professor, School of Law
University of Washington

Since the early 2000s, the Asian region has been transforming itself economically through institutional links that are unprecedented in the degree of their legal formality. By one account, near the end of 2004 there were an estimated 44 Free Trade Agreements (FTAs) or Economic Partnership Agreements (EPAs) initiatives involving East Asian countries that had been concluded or were under negotiation or study.[1] Of these, 43% were agreements between Asian countries. These ambitious legal links have begun to redefine the geographical boundaries of the region, linking concrete corporate and governmental interests across Northeast, Southeast, and now even South Asia. Emboldened by the nesting of investment treaties and free trade agreements, as well as the forging even of an Asian currency unit, Asian actors have begun to speak confidently of an economic "power shift" underway from America and Europe towards the Asian quad of Japan, China, Korea and India.[2] Their efforts may not be moving at top speed. Their rhetoric may not be widely appreciated. Their self-perceptions may be questioned. But bit by bit the actions of these dominant Asian powers are redrawing the institutional map of a new Asia in a way that has direct, and possibly even negative, implications for the continued standing and influence of the United States within the region.[3]

This paper focuses on the implications of these ongoing Asian developments from the standpoint of the United States, and the future of the US-Japan economic relationship. Its main argument is that the US needs to focus on a policy of sustainable engagement in the Asian region as a whole – a comprehensive strategy that will ensure the continuation of fair access for American market participants in the ongoing regional economic integration; and a concrete method that will safeguard US political interests despite the proliferating regional Asian institutions. One route to sustainable engagement in Asia for the US is through reinforcing and recasting its economic relationship with Japan – an advanced industrial democracy in the region that also happens to have proven itself as one of the most steadfast military allies of the US over the postwar period.

The remainder of the paper is in four parts. The first part briefly sets out a brief overview of changing economic realities and shifting Japanese interests. Both have combined to highlight the necessity of new institutional mechanisms that will allow the US to anchor itself more solidly in the region. The second part turns to a consideration of calls for a US-Japan FTA, focusing on both legal and economic welfare concerns. The third part turns to specific ways in which the US can recast its relationship with Japan. Rather than endorsing a direct comprehensive FTA between the world's first and second largest economies at this stage it sets forth a more practical "BITs and Block" approach in which economic integration can be put in motion in a piecemeal fashion. The fourth part concludes.

1. The Background of Shifting Interests

The fact is that the United States cannot afford to take its long dominant position for granted in an Asian region that is increasingly, and irreversibly, Asia-bound.[4] Nor should it even count on the centrality of the US-Japan economic relationship to continue to cement its interests in the region. The Japanese Ministry of Economy, Trade, and Industry (METI) has already highlighted the shifting economic weight for Japan towards Asia – a reality that has come about naturally through the operations of market actors over the past few decades and that appears to be accelerating at the present stage.[5] Whereas Japanese trade volumes of exports and imports actually declined to both the EU and the US by the early 2000s, they increased in East Asia (referring to ASEAN10, China, Korea, Chinese Taipei and Hong Kong, China). The Japanese shares of Asian trade then already stood at 40% for exports, 41% for imports and 26% for investments. More recently, the influential US-Japan Business Council confirms that Japan trade reliance on the US and Europe in comparison to East Asia is in fact continuing to decrease markedly.[6] 30% of Japan's exports headed to the US in 2000 as compared to 22.5% in 2005; US shares of Japanese imports also declined from 19% to 12.5% in those years. There is little question that much of Japan's trade is now headed for and likely to be reinforced in the Asian region. On the US side, Japan is still the top non-NAFTA (after Canada and Mexico) market for exports of US manufactured goods, agricultural products, and services, all estimated at around $80-90 billion annually. But US total trade with Japan has been declining while rising with other trade partners. By 2005, China had passed Japan to become the top non-NAFTA partner for the US in terms of total trade encompassing exports and imports. The same was true for Japan. By 2004, China had replaced the US as Japan's largest trade partner.[7]

While statistical trends may go up and down, what is more important from a policy perspective is that there continues to be high optimism among Japanese government and business leaders about increases in profits in East Asia and consequently positive effects on Japan's economic well being in the long run. It is helpful to briefly outline the reasons for Japan's shift towards preferential trade diplomacy as some of its specific elements have a bearing on the possible design and contents of the US-Japan relationship. Japan's new Asian-centricism had extra-regional roots that were linked to the hemispheric schemes of the US in the early 1990s. It was the North American Free Trade Agreement (NAFTA), by far the most economically important of the United States' FTAs to date, which was critical in marshalling Japanese business support for similar ventures both regionally and extra-regionally. As the US and EU expended considerable energy on FTA diplomacy, Japan too openly admits to playing catch-up in a global FTA game that was having a negative effect, in terms of trade diversion and discrimination, on

some of its most significant industries such as automobiles and electronics.[8] FTAs abroad hit home economically hard for such business concerns in a number of ways, such as relatively higher tariffs and unfavorable treatment in licensing, investment protection, and government procurement contracts – a prospect that should also serve as a warning to US interests operating in East Asia today which will face discrimination or, at the least, higher transaction costs due to the overlapping web of agreements being put in place.[9]

Japan's preferential FTAs are able to deliver speedy and specific benefits in terms of preferential access to and control of entry to particular markets – factors that are especially attractive to concentrated big business interests in Japan that have strong and unabated ambitions in the Asian region. It is not a surprise that Japanese automobile, electronics, and even steel makers, which constitute some of Japan's most formidable global competitors, are behind the turn to bilateral and regional FTAs. Indeed officials acknowledge that the Japanese-Mexico Agreement was pushed and applauded by the Japanese automobile as well as electronics industry.[10] The same is true even of declining sectors in Japan, such as textiles and even agriculture, whose competitive high-value added niches also appear to be quite supportive of Japan's new diplomacy.[11] The advantages of the FTA policy for the Japanese economy as a whole is that it is promises quick and targeted liberalization benefits to specific sectors that potentially could spill over and also force competitive changes even in highly protected sectors like agriculture and textiles. Although Japan has thus far concentrated its preferential diplomacy on comprehensive EPAs, such targeted liberalization efforts on behalf of some sectors also raises the possibility of instituting more specific approaches to liberalization that directly answer business needs and concerns across other regions.

Japan is also to a considerable extent seeking to correct the institutional imbalance that have accompanied the rapidly expanding trade and investment ties in Asia, and in which Japanese corporations have played an important role.[12] It is governmental efforts in many ways that are playing catch-up to the spread of the regional market.[13] Japan's bilateral and preferential FTA agreements in the region, like similar intra-Asian initiatives by other Asian governments, are the building blocks to genuine, ground-up, and made-for-and-by Asians institutionalism of which there has been much talk and commotion over the past few decades but not really much substantive action thus far.[14] Whether ultimately beneficial from a global or even regional economic welfare point of view or not, these agreements will certainly make the political-institutional side much more concrete in the case of Asia. These arrangements will allow for stability of political and business expectations about partners' behavior. In the aftermath of the Asian financial crisis, which threw the lack of coherent Asian institutional structures into stark relief for the world to see in the late 1990s, the view is also that they will potentially allow the signatory countries to deal with ad hoc crises and uncertainties in the same set forums.

Talk of extra-regional agreements notwithstanding, there is a clear geographical component at stake that is not likely to reverse. This is evident not just in the economic trends but also the institutional ones accompanying them. The fact is that the institutional engineering currently underway in Asia by Japan and other Asian countries is designed to reinforce, whether intentionally or not, an Asia-centered economic reality.[15] Irrespective of the slowness, setbacks, and rivalries characterizing any one FTA/EPA initiative in the region, there is little question that their sum total will take Asia institutionally forward in this new century. The piecemeal institutions being put in place today will themselves merge and fuse in a far more economically integrated new Asia in the not too distant future. At that future point, having maneuvered through the existing strengths of the US-Japan economic relationship at present will ensure that

US interests will have been part and parcel of the institutional processes from the ground up.

2. The Movement towards a US-Japan FTA

If economic realities and institutional engineering stay the course, then there can be little question that the United States' most important security ally in the region is increasingly Asia-bound. Japan's geography, from which it cannot escape, may also well ultimately dictate its pro-Asia economic and political destiny. The US cannot reverse any of these ongoing economic, political and institutional trends which now have an in-built momentum and logic of their own. All it can do is to take their implications into account both for its standing in the region and its continued relationship with Japan in the future.

The departure point for reassessing the US-Japan relationship is to understand the implications of exactly these trends: The US will be a marginal player in this new Asia, and there are economic and political forces at play that are well served by elbowing the US out of developments in the region. One way to ensure a sustainable engagement with the region in light of these trends is by recasting the US-Japan economic relationship – to parlay its existing strengths for a more durable presence in the region. Such a move would begin cementing the economic side of the US relationship with Japan and bring it legally and institutionally up to par with the long standing US-Japan security alliance.

It is easy to speak of recasting relationships. But what exactly might the shape of future US-Japan economic relationship look like? The US-Japan relationship has come a long way from the trade friction over the postwar period for both economies, the alarmist declining-power scenarios in the 1980s for the US, and the economic doldrums of the 1990s for Japan. As a chorus of influential voices in both economies suggests at the close of the 2000s, at no moment perhaps in their postwar economic relationship have the prospects for a US-Japan FTA seemed so plausible.[16] Of course, this idea is hardly new. Its origins can be dated as far back as the 1980s, a decade that was marked by excessive trade friction between the two economies.[17] With the signing of the US-Canada FTA in 1988, a number of high-ranking ambassadors, policymakers, and politicians vocally urged the same course of action for the US and Japan. In the US, despite the discordant economic relations between US and Japan at that time, things proceeded far enough that a House Bill was introduced to urge the President to initiate consultations with the Government of Japan to determine the feasibility and desirability of negotiations over an FTA.[18]

The prospects for a US-Japan FTA has certainly been resurrected at a propitious time in history at the close of the 2000s – one in which the trend towards such agreements is taken for granted in both the US and Japan, and one in which there is little hope of returning anytime soon to a multilateral liberalization round under the WTO. But there are two sets of valid concerns that need to be addressed: legal concerns that bear upon the thorny political issue of agricultural liberalization, and also economic ones that call into question the issue of gains to be had from any such agreement. While certainly important, neither of them is as important an impediment to the institutionalization of a US-Japan FTA as made out to be in public discourse.

Legal Constraints Concerns

To understand the issue of consistency with international rules requires at least a basic understanding of the relevant WTO/GATT provisions.[19] Within them the general concept of regional trade arrangements (RTAs) itself includes both FTAs and Customs Unions (CUs) which then deal with trade in goods, services, and relations across developed and developing countries. Specifically, GATT Articles XXIV (as clarified in the Understanding on the Interpretation of Article XXIV of the GATT 1994) is concerned with FTAs and CUs related to trade in goods. Article V of the GATS covers RTAs dealing with trade in services for both developed and developing countries. And finally, Article 2(c) of the Enabling Clause (formally, 1979 Decision on Differential and More Favorable Treatment Reciprocity and Fuller Participation of Developing Countries) refers to preferential agreements in goods between developing country members. From a legal standpoint, of relevance to the US-Japan FTA are GATT XXIV and GATS Article V.

A closer look shows that GATT Article XXIV.4 lauds the desirability of closer voluntary economic integration among countries as a means of facilitating and increasing the freedom of trade. With that goal in mind, GATT Article XXIV.5 then pinpoints three specific channels through which such integration may proceed: first, the formation of a free-trade area in which members eliminate internal trade barriers among themselves but set their own external tariffs and trade policies against non-members; second, the formation of a customs union, in which members eliminate internal trade barriers among themselves and also establish common external tariffs and trade policies against non-members; and finally, the adoption of an interim agreement necessary for the formation of a customs union or free-trade area. GATS Article V is concerned with economic integration, and does not explicitly mention CUs or FTAs; but like GATT Article XXIV it too focuses on substantial sectoral coverage and the elimination of discrimination.

In a nutshell, the provisions allow for a preferential trade agreement provided certain conditions are met by WTO members – that the agreement covers substantially all the trade between WTO members (internal trade requirement), that it eliminates internal trade barriers within a reasonable period of time between them (reasonable period requirement), that it does not resort in more severe barriers for non-members (external trade requirement), and that it is transparent to all through notification to the WTO (transparency requirement).[20] The clause that has gotten the most public attention concerns substantial coverage of trade relations.

However, the substantiality test is far from a settled matter in WTO jurisprudence, and debates about its quantitative (a specific numerical percent of all trade for liberalization) and qualitative (no specific sector exemptions from liberalization) operationalization go on and can, no matter which interpretation is used, justify sectoral exclusions among parties. Meanwhile, back in the real world, the fact is that exclusions are the order of the day, and the WTO Secretariat itself noted even in 1998 that 56 out of the 69 RTAs then in force excluded some agricultural products and 2 excluded all agricultural products outright. The same continues to be true at the close of the 2000s. The recent example of the 2000 EU-Mexico FTA is also often highlighted to show that politically sensitive items like agriculture can be given exceptional treatment and excluded from the agreement.[21] The defense in terms of WTO-consistency by the parties was that the agreement liberalized 95% of total bilateral trade volume, higher in fact than the internal EC benchmark at 90% of trade liberalization. Not surprisingly, both the US and Japan have also moved to exclude sensitive goods in FTA negotiations and agreements – for example, the US-

Australia FTA excludes sugar, the Japan-Thailand one leaves aside rice. Thus, while not a good precedent from a WTO rule-based point of view, exclusions do exist in FTAs and they may potentially be the FTA maker or breaker in a possible US-Japan FTA. All this is not to say that the US and Japan need to openly flout the rules. But given the murkiness thus far in WTO governance of RTAs altogether, any movement towards an FTA between the world's first and second largest economies will have exclusions and will be discriminatory, but it may well have the one advantage of bringing pressure for clarity on existing WTO jurisprudence. Additionally, as discussed subsequently the range of existing WTO rules also makes clear that the governing rules for FTAs in merchandise goods and services are distinct – a feature which allows us to separate blocks of economic relations from each other.

TABLE 1: Economic Agreements Negotiated by the United States

Agreement Type	Year	Countries	Two-way Trade Volume with US (2005, US$ Mil)
BILATERAL			
Andean Trade Promotion Agreement			
Colombia Trade Promotion Agreement	2006	Colombia	14,261
Peru Trade Promotion Agreement	2006	Peru	7,410
Australia Free Trade Agreement	2005	Australia	23,111
Bahrain Free Trade Agreement	2004	Bahrain	783
Chile Free Trade Agreement	2003	Chile	11,864
Israel Free Trade Agreement	1985	Israel	26,607
Jordan Free Trade Agreement	2000	Jordan	1,910
Korea Free Trade Agreement	Under negotiation	Korea	71,449
Malaysia Free Trade Agreement	Under negotiation	Malaysia	44,154
Morocco Free Trade Agreement	2004	Morocco	971
Oman Free Trade Agreement	Under negotiation	Oman	1,148
Panama Free Trade Agreement	Under negotiation	Panama	2,496
Singapore Free Trade Agreement	2003	Singapore	35,764
Thailand Free Trade Agreement	Under negotiation	Thailand	27,125
United Arab Emirates Free Trade Agreement	Under negotiation	United Arab Emirates	9,946
Japan	**Unofficially suggested**	**Japan**	**193,501**
REGIONAL			
Asia-Pacific Economic Cooperation (APEC)	1989	Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taipei, Thailand, Viet Nam	1,579,249
Association of South East Asian Nations (ASEAN) Initiative	Under negotiation	Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam	148,530
Central America-Domincan Free Trade Agreement (CAFTA-DR)	2004	Costa Rica, Domican Republic, El Salvador, Guatemala, Honduras, Nicaragua	34,904
Free Trade Area of the Americas (FTAA)	Under negotiation	Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay	976,737
Middle East Free Trade Area Initiative (MEFTA)	Under negotiation	Algeria, Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, UAE, Yemen	114,286
North America Free Trade Agreement (NAFTA)	1994	Canada, Mexico	789,537
South Africa Customs Union Free Trade Agreement (SACU FTA)	Under negotiation	Botswana, Lesotho, Nambia, South Africa, Swaziland	10,855

Source: Trade agreements from the Office of the United States Trade Representative (USTR), available online at http://www.ustr.gov/Trade_Agreements/Section_Index.html (accessed 1 September 2006): and data from Interactive Tariff and Trade Dataweb, United States International Trade Commission (USITC), available online at http://dataweb.usitc.gov (accessed 1 September 2006).

Economic Gains Concerns

A second concern is about the economic gains to be had from any sort of a comprehensive US-Japan agreement. The argument is that merchandise trade between the two is already subject to low tariffs, and that very little is to be gained from actually institutionalizing trade processes that are well integrated. The focus on gains, while certainly important, also needs to be viewed in comparative light of the gains that are supposedly had in any other FTA negotiated by the US thus far, whether viewed in terms of the absolute volumes of trade or the estimated impact on real GDP.

The facts cast doubt on the efficacy of focusing on economic gains altogether as a motivation for FTAs. First the absolute volume of trade in the agreements negotiated thus far by the US is not particularly impressive, with the sole exception of the NAFTA countries. Table 1 gives a comprehensive overview of the present state of the US agreements in place thus far at both the bilateral and regional level, and also the volume of two way trade between the US and its trade partners under both sets of arrangements. Looking across the two-way trade, it is clear that in terms of sheer trade volumes the United States' NAFTA agreement is the only one that is economically significant. The next one down is clearly US total trade with Japan, with which there is no formal agreement in place. The trade volumes of the remainder of the FTA partners for the US are well below the NAFTA and even Japan figures. In fact, neither the US (excepting NAFTA countries) nor Japan has really selected any significant trade partner in terms of volumes.[22] Between 1995 to 2004, US FTA partners in Latin America, the Middle East and the Asia-Pacific had bilateral trade shares ranging from less than 0.1% (e.g. Jordan) to just 1.0% (e.g. Israel, Australia) and onto a mere 2.0% (e.g. Singapore). Similarly, Japan's trade shares with Mexico (0.8%), Singapore (3.1%) and Malaysia (3.0%) during the same period of time are relatively low. Overall, if anything, the US appears to have targeted even less significant trade partners than Japan.

If trade volumes are so small with such FTA partners, it is hard to believe that there is any sizable impact on the GDP of either the US or Japan from any one agreement. In fact, as most economic models suggest, the gains for the US economy, as well as Japan, are small given the low volumes of bilateral trade shares with their present set of FTA partners.[23] Furthermore, virtually every simulation done on the topic suggests that both the US and Japan stand to gain most in terms of economic welfare under a multilateral liberalization round such as that under the auspices of the WTO rather than through bilateral or regional FTAs. Even assessments of the economic impact of the sizable NAFTA agreement on the US GDP have proved to be controversial and, more importantly, are still considered fairly minor as predicted at the start of NAFTA.[24] One recent estimate in 2003 suggests that the NAFTA impact is only around $2 billion in a $10 trillion US economy on an annual basis, and no matter what the true trade and welfare effects the fact is that the actual magnitudes are likely to remain small compared to the size of the US economy.[25] This means that all the other agreements that the US is now signing are virtually guaranteed to have no visible effect on the overall US economy given their low scales. Going forward with these realities already at play also means that we can expect a largely insignificant impact of even a comprehensive US-Japan FTA on the respective economies. One study confirms just that with the finding that while trade volumes might well be stimulated by a sizable amount, real GDP would not increase that much for either the US or Japan.[26] The predicted macroeconomic impact in terms of increases in Japan's real GDP is estimated to be about 0.15%; the estimate of the impact on the United States' real GDP is even lower at 0.01%.

3. The Advantages of a "BITs and Block" Approach

If the overall economic gains between FTA partners with even sizable trade volumes, such as NAFTA, are fairly minor then the fact is that the advantages to having FTAs, as between the US and Japan, must lie elsewhere. What exactly might these be? The following discussion suggests briefly discusses two advantages that could come about pragmatically through what I am calling the "BITs and Block" approach – that is, an approach that focuses on different pieces of the US-Japan economic relationship and brings them under rule-based control to advantage players in both economies.

First, in terms of gains, while the overall economic gains might be negligible, specific blocks of competitive industries do stand to gain. In a comprehensive US-Japan agreement estimates suggest that Japan's globally competitive sectors such as machinery, electronics, and especially automobiles would expand; for the US the competitive agricultural and food sectors would expand. The pattern of trade flows also suggests the possibility of gains by other specific blocks. Although Japan has slipped in total trade volume with the US as noted above, it nevertheless remains the second largest market for US services exports and the US is the largest single market for Japanese foreign direct investments.[27] Tables 2 and 3 give a clearer picture of the importance of services and investment in the US-Japan trade relations, and suggest that promotion in both categories would be beneficial to current American and Japanese businesses.

TABLE 2: US Trade with Japan by Major Categories (US$ Billion)

	1995	2004
US Exports		
Manufactured Goods	43.6	41.5
Agricultural Goods	11.1	8.1
Services	33.1	35.2
US Imports		
Manufactured Goods	123.6	128.5
Agricultural Goods	0.3	0.4
Services	13.4	19.6
Balance		
Manufactured Goods	-80	-87
Agricultural Goods	10.8	7.7
Services	19.7	15.6

Source: USJBC, *2006 Policy Statement*, p. 5.

TABLE 3: General Investment Positions of the US and Japan (US$ Billion)

	1995	2004
US in Japan		
Manufacturing	15.7	14.6
Wholesale Trade	5.9	8.2
Finance	7.6	39.2
Professional Services	1.1	7.7
Japan in US		
Manufacturing	25.0	60.0
Transportation	-	24.7
Wholesale Trade	34.5	68.2
Finance (ex insurance)	17.7	13.5
Real Estate	8.7	7.3

Source: USJBC, *2006 Policy Statement*, p. 6, 8.

Focusing on these blocks of economic realities – such as a services agreement, which comprises a huge proportion of US exports to Japan; and an investment BIT (Bilateral Investment Treaty), which draws upon the work done under the US-Japan Investment Initiative since 2002 – would parlay the existing strengths of the economic relationship and insert rule-based liberalization in blocks that could then be appended upwards in a more comprehensive economic partnership. Additional blocks of economic interest on both sides – such as intellectual property, antidumping remedies, and competition policy – could similarly use the existing frameworks of agreements and negotiations already in motion between the US and Japan as a basis for more formal legal agreements. For example, a legal document on competition policy could draw upon the Regulatory Reform and Competition Policy Initiative in place since 2001, under which annual reports have been emerging since that time.

This approach does not disregard agricultural issue but does note that its high degree of politicization and relatively more modest weight (as compared to US services and manufacturing exports to Japan) do not make it the ideal starting point for any kind of a movement towards an FTA. The BITs and Block approach does not seek to bypass agricultural concerns; rather it suggests liberalization efforts should be pinpointed on those products that are less politically sensitive than others – itself a painstaking process which could go on to create pressures for agricultural liberalization as a whole. This is especially important because the US has of course tried to engage Japan in agricultural liberalization using APEC as a vehicle. The lessons in the Early Voluntary Sector Liberalization (EVSL) under APEC in 1997 – which can actually be thought of as an exercise in a bilateral US-Japan FTA negotiation under the cover of APEC – do not bode well for the future of any kind of speedy or imposed agricultural liberalization efforts between the US and Japan anytime soon.[28] The BITs and Block approach would allow both parties to exert greater control over the processes of agricultural liberalization in Japan, as well as stable market in politically sensitive sectors like steel in the US, under a rule-based rubric.[29]

While debates about measurable economic benefits are important, far more attention should also be paid to institutional underpinnings which are equally critical to the smooth functioning of markets. The largely invisible effect of such features should not be underestimated, especially for the two parties involved. Improvements in regulatory transparency, taxation simplification, customs procedures, standards harmonization, movement of natural persons, and trade facilitation generally can all improve the underlying prospects for economic integration across nations. The impact of these factors can help lower transactions costs of doing businesses across borders, and might also spill over and have a positive impact on reinforcing social and political relations.

Second, in terms of geostrategic concerns, there is the issue of slipping US influence in the region. As pointed out earlier, no one single measure on the part of the US can now reverse the Asia-centric economic and institutional momentum underway in the region. All the US can do is safeguard the American economic interests already there, and to ensure that future ones are not shut out – needs that can be pragmatically and speedily served under the BITs and Block approach. As the demographic and economic weight of the world shifts towards Asia, where there are strong undercurrents of anti-Americanism, there is a real temptation to become a highly activist institution setter within the region. But just as the US did not enmesh itself in the slow institutional underpinnings of a economically integrating Europe in the postwar period, it should also stand apart from the natural rush to institutional integration unfolding in Asia today. The fact is that, despite political cries to the contrary, the US is not an Asian power and does not even have much formal institutional engagement in the regional economy.[30]

Estimates suggest that the Asia-Pacific region accounted for 32% of total US global merchandise trade in the early 2000s, but only 16% of direct investment.[31] The state of the United States' institutional engagement in Asia needs to be kept in mind. As shown in Table 1 earlier, the US has moved to bind itself through three direct bilateral FTAs and one regional one (leaving aside APEC), all agreements with total trade volumes considerably lower than that with Japan. Tables 4, 5 and 6 also help in assessing the sum total of the focus of US agreements in the Asian region: As of 2006, the US has a few Trade and Investment Framework Agreements (TIFAs), a scarce number of BITs largely in South and Central Asia, and a fair number of Intellectual Property Rights Agreement (IPRAs).

TABLE 4: Trade and Investment Framework Agreements (TIFAs) Negotiated by the United States

Agreement	Year	Countries, other than US (if regional)
BILATERAL		
US-Algeria TIFA	2001	
US-Bahrain TIFA	2002	
US-Cambodia TIFA	2006	
US-Ghana TIFA	1999	
US-Kuwait TIFA	2004	
US-Mozambique TIFA	2005	
US-Nigeria TIFA	2000	
US-Pakistan TIFA	2003	
US-Qatar TIFA	2004	
US-Saudi Arabia TIFA	2003	
US-South Africa TIFA	1999	
US-Thailand TIFA	2002	
US-Yemen TIFA	2004	
REGIONAL		
US-Association of South East Asian Nations (ASEAN) TIFA	2006	Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam
US-Central Asia TIFA	2004	Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan
US-Common Market for Eastern and Southern Africa (COMESA) TIFA	2001	Angola, Burundi, Comoros, D.R.Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, Zimbabwe
US-West African Economic and Monetary Union (WAEMU) TIFA	2002	Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, Togo

Source: USTR at http://www.ustr.gov/Trade_Agreements/TIFA/Section_Index.html (accessed 13 September 2006).

TABLE 5: Bilateral Investment Treaties (BITs) Negotiated by the United States

Country	Date of Entry into Force
Albania	1998
Argentina	1994
Armenia	1996
Azerbaijan	2001
Bahrain	2001
Bangladesh	1989
Belarus	Pending
Bolivia	2001
Bulgaria	1994
Cameroon	1989
Congo, Rep. (Brazzaville).	1994
Congo, Dem. Rep.	1989
Croatia	2001
Czech Republic	1992 (2004)
Ecuador	1997
Egypt	1992
El Salvador	Pending
Estonia	1997 (2004)
Georgia	1997
Grenada	1989
Haiti	Pending
Honduras	2001
Jamaica	1997
Jordan	2003
Kazakhstan	1994

Country (contd.)	Date of Entry into Force
Kyrgyzstan	1994
Latvia	1996 (2004)
Lithuania	2001 (2004)
Moldova	1994
Mongolia	1997
Morocco	1991
Mozambique	2005
Nicaragua	Pending
Panama	1991
Poland Business and Economic Relations Treaty	1994 (2004)
Romania	1994
The Russian Federation	Pending
Senegal	1990
Slovakia	1992 (2004)
Sri Lanka	1993
Trinidad and Tobago	1996
Tunisia	1993
Turkey	1990
Ukraine	1996
Uruguay	Pending
Uzbekistan	Pending
Viet Nam Agreement on Trade Relations	2001

(Date of Official Revisions in Parentheses)

Source: Information on US BITs is available through the USTR website at tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp, and the US State Department at http://www.state.gov/e/eb/rls/fs/2006/22422.htm (both accessed 13 Sept 2006).

TABLE 6: Intellectual Property Rights Agreements (IPRA) and Related Understandings Negotiated by the United States

Agreement	Year
Bahamas Letter of Understanding on the Copyright Act and Regulations	2000
Berne Convention	1971
Bulgaria IPRA	-
Cambodia Trade Relations & IPRA	1996
Ecuador IPRA	1993
Hungary IPRA	1993
Jamaica IPRA	1994
Japan Actions to be Taken by the Patent Offices	**1993**
Japan Mutual Understanding on Patents	**1994**
Japan Resolution on WTO Dispute of Sound Recordings	**1997**
Korea Intellectual Property Rights & Insurance Understandings	1987
Latvia Trade Relations and IPRA	1994
Nicaragua IPRA	1998
North American Free Trade Agreement (NAFTA) Preamble	1994
Paraguay Intellectual Property Rights Memorandum of Understanding (MOU)	2004
Paris Convention	1967
People's Republic of China Implementation of the 1995 IPRA	1995
People's Republic of China Intellectual Property Rights Memorandum of Understanding (MOU)	1992
Peru Memorandum of Understanding (MOU) on IPR	1997
Philippines IPR Understanding	1993
Sri Lanka IPR	1991
Chinese Taipei Agreement on Intellectual Property Protection (Trademark)	1993
Chinese Taipei Copyrights/Trademarks/IPR Understandings--American Institute in Taiwan (AIT) And Coordination Council for North American Affairs (CCNAA) Copyright Agreement	1993
Chinese Taipei Copyrights/Trademarks/IPR Understandings--CCNAA and AIT IPR Understanding	1992
Trinidad and Tobago IPRA	1994
Viet Nam Establishment of Copyright Relations Agreement	1997
World Intellectual Property Organization (WIPO) Copyright Treaty	1996
WIPO Performances and Phonograms Treaty	1996
World Trade Organization (WTO) Agreement on Trade-Related Aspects of IPR	1994

Source: US Trade Compliance Center, available online at http://tcc.export.gov/Trade_Agreements/Intellectual_Property_Rights/index.asp (accessed 13 September 2006).

Any major moves on the part of the US can be seen as encirclement by other regional players, interpreted as an attempt to thwart the progress of political institutionalization by regional players, or may even just fan the winds of anti-Americanism or American distrust in the region. With a focus on reinforcing competitive blocks in the US-Japan economic relationship, the BITs and Block approach alleviates geostrategic concerns that the US is seeking to contain or constrain other regional players through a comprehensive FTA agreement between the world's first and second largest economies. It nevertheless allows the US to create pathways for exerting influence and maintaining a solid economic presence through Japan. It also has the virtue of assuring Japanese players that the US is not simply bypassing Japan in favor of other players in the region – an element that has already begun to have subtle repercussions on the way Japan aligns itself with US positions on other global issues.

4. Conclusion

Although Japan's bilateral FTA diplomacy has a cross-regional element, economic realities and geographical imperatives make it clear that Asia is the prime target of its new diplomacy. Even in this scenario, the critical question to ask is not whether the prospects of a comprehensive US-Japan FTA are good. In the end any FTA between these two global trade powers is certainly not going to be decided solely on the basis of aggregate economic concerns just as it is not likely to be constrained by legal niceties alone. From a pragmatic point of view, any such FTA is not going to come about overnight. The BITs and Block approach helps move towards such a lofty goal, answering concrete concerns of businesses in both economies along the way. It also leaves both economies considerable flexibility in forging other bilateral, regional and multilateral initiative that are in line with their interests – initiatives in which the two economies can jointly parlay their own gains and rules stemming from common formal agreements between them. If they are both truly serious about exerting influence in the global trading system, the real importance of a comprehensive FTA is that these dominant economic powers could use it as a building block in the stalled WTO liberalization round.

The real focus of questions should thus be what we would want any such FTA to do. This is what the debate needs to center on. Frankly, a US-Japan FTA is not the economic and political solution it might at first appear to be for a range of vague concerns. It will not stop the thrust of Asia-centric economic realities and accompanying institutional engineering. It will not stop Japan, and other Asian countries, from economically integrating further in Asia and away from the US. It will not transform the US into an Asian power. It will not give the US much greater leverage in the economic, political or security realms than it has now with actors in the region. All the BITs and Blocks on the way to any such FTA with Japan, and possibly other partners in the region, can do is to allow the US to safeguard its economic, and to some extent geostrategic, interests in the unfolding regional system through a sustainable mode of engagement; and perhaps also allow the US to ideally use the approach to revitalize the multilateral trading system.

[*] I wish to thank several people in Japan for taking the time to share their views with me, especially Hisamitsu Arai, Noboru Hatakeyama, and Masakazu Toyoda. In addition, I thank Jacob Brown for his excellent research assistance.

[1] See generally Masahiro Kawai and Taizo Mononishi, "Is East Asia an Optimum Currency Area?," (available online at http://www.mofa.go.jp), Table 6.

[2] "Ajia to Renkei Hitsuyō – Keidanren Fooramu [Cooperation with Asia Necessary – Keidanren Forum]," *Asahi Shinbun*, 24 July 2004; and "Ajia ni Kyōtsū Tsūka o [A Common Currency in Asia], *Asahi Shinbun*, 1 September 2006.

[3] Although interest in Asia has been reinvigorated by the burgeoning preferential trade diplomacy in the region, some works are already pointing rightly to far more multi-faceted economic, political and social elements in the new Asian regionalism. See T. J. Pempel, *Remapping East Asia: The Construction of a Region* (Ithaca: Cornell University Press 2005); and Peter J. Katzenstein and Takashi Shiraishi, eds., *Beyond Japan: The Dynamics of East Asian Regionalism* (Ithaca: Cornell University Press, 2006).

[4] Dajin Peng, "Subregional Economic Zones and Integration in East Asia," *Political Science Quarterly*, Vol. 117, No. 4 (Winter 2002-2003), pp. 613-641.

[5] METI, *Promotion of Economic Parternship*, December 2002, p. 7-8 (available online at http://www.meti.go.jp).

[6] US-Japan Business Council (USJBC), *2006 Policy Statement*, p. 3-8 (available online at http://www.usjbc.org).

[7] "China Replaces United States as Japan's Top Trade Partner," *The Asahi Shinbun*, 27 January 2005 (available online at http://www.asahi.com); and "China Becomes Japan's Top Trade Partner," *China Daily*, 26 January 2005 (available online at http://www.chinadialy.com.cn).

[8] Mireya Solis, "Japan's New Regionalism: The Politics of Free Trade Talks with Mexico," *Journal of East Asian Studies*, Vol. 3, No. 3, 2003.

[9] See, for example, Statement of Samuel L. Maury, President of The Business Roudtable before the Subcommittee on Trade of the Committee on Ways and Means, US House of Representatives, 29 March 2001 (available online at http://www.businessroundtable.org).

[10] Interview, MOFA Official, 21 July 2004.

[11] Reportedly, a Japanese textile industry association, which wanted to expand its high-tech fiber products, has reached an agreement concerning textile tariff elimination with its counterparts in Thailand, Malaysia and the Philippines. See *International Herald Tribune/Asahi Shimbun*, 21 July 2004.

[12] Walter Hatch and Kozo Yamamura, *Asia in Japan's Embrace: Building a Regional Production Alliance* (Cambridge University Press, 1996).

[13] Naoko Munakata, "Has Politics Caught Up With Markets? In Search of East Asian Economic Regionalism," in Peter J. Katzenstein and Takaishi Shiraishi, eds., *Beyond Japan: The Dynamics of East Asian Regionalism* (Ithaca: Cornell University Press 2006), pp. 130-157.

[14] John Ravenhill, *APEC and the Construction of Pacific Rim Regionalism* (New York: Cambridge University Press, 2001).

[15] See the presentation by Shujiro Urata, "Proliferation of FTAs in East Asia," RIETI BBL Seminar, 8 April 2005, (available online at http://www.rieti.go.jp)

[16] See, for example, Noboru Hatakeyama, "Japan's New Regional Trade Policy – Which Country Comes Next After Singapore," Second Annual Whitman International Lecture, Washington DC, 13 March 2002 (available online at http://www.iie.com); "Speech of U.S. Senator Max Baucus Regarding Asia Trade Policy to the Institute for International Economics: Integration of Asian Economies," US Senate Committee on Finance, 8 December 2004 (available online at finance.senate.gov); C. Fred Bergsten, "The Resurgent Japanese Economy and Japan-United States Free Trade Agreement," Paper presented to the Foreign Correspondents' Club of Japan, Tokyo, 12 May 2004 (available online at http://www.iie.com); and Robert C. Fauver and Devin T. Stewart, "U.S.-Japan Comprehensive Economic Partnership Agreement: Cementing a Geostrategic Economic Relationship," *SAIS Review*, Vol. XXIII, No. 2 (Summer-Fall 2003), and USJBC, *2006 Policy Statement* (available online at http://www.usjbc.org).

[17] United States International Trade Commission (USITC), "Pros and Cons of Initiating Negotiations with Japan to Explore the Possibility of a U.S. – Japan Free Trade Area Agreement," Report to the Senate Committee on Finance on Investigation No. TA-332-255 under Section 332 of the Tariff Act of 1930, USITC Publication 2120, September 1988; Makoto Kuroda, "Strengthening Japan-US Cooperation and the Concept of Japan-US Free Trade Arrangements," in Jeffrey J. Schott, ed. *Free Trade Areas and U.S. Trade Policy* (Washington DC: Institute for International Economics, 1989). See also select media coverage from the late 1980s to the mid 2000s, showing changes in the prospects for a US-Japan FTA in "ITC Urges Caution on US-Japan Free Trade Pact," *Japan Economic Newswire,* 20 September 1988; "Hills Skeptical About US-Japan Free Trade Pact," *Japan Economic Newswire,* 1 March 1989; "Free Trade With Japan: The Time is Ripe," *Christian Science Monitor*, 20 October 1992; "Mansfield Urges US, Japan to Consider Free-Trade Zone," *The Nikkei Weekly*, 6 June 1992; "Bill Seeks US-Japan Free Trade Accord," *Jiji Press Ticker Service*, 4 March 1993; "Excerpts From Clinton Policy Speech," *Japan Economic Newswire*, 7 July 1993; "Japan Needs Fresh Ideas as US Relationship Evolves – On Economics, Free-Trade Pact Could Deepen Ties; On Security, Nation Must Break Out of Dependence," *The Nikkei Weekly*, 5 May 1997; "Japan, US Business Leaders to Meet, Discuss Japan Economy," *Japan Economic Newswire,* 8 February 2002; "Japan, US Set for Game of Diplomacy on FTA," *The Nikkei Weekly*, 7 June 2004; "US Analyst Seeks US-Japan Economic Pact to Check China," *Jiji Press Ticker Service*, 7 June 2005; "Japan, US Should Promote Economic Integration: ACCJ,"

Japan Economic Newswire, 22 June 2006; "Why Saying 'Sayonara' Is the Hardest Thing to Do," *Financial Times*, 27 June 2006; "Links Between Japan and US are Under Pressure from Burgeoning Accords in Asia-Pacific Region," *Financial Times*, 30 June 2006; and "Nichibei FTA ni Sekkyokusei Motomeru – Chūnichi Beitaishi [US Ambassador in Japan – Initiative on US-Japan FTA], *Nihon Keizai Shinbun*, 16 February 2006.

[18] US House of Representatives, H.R. 1051, To Authorize the Establishment of a United States – Japan Free Trade Area, 101st Congress, 22 February 1989.

[19] See GATT Article XXIV, GATS Article V more generally, and the Enabling Clause in the Decision of 28 November 1979 (L/4903) (available online through legal documents at http://www.wto.org).

[20] The following discussions of the compatibility issues of CUs and FTAs with GATT/WTO provisions draws on Mitsuo Matsushita, "Legal Aspects of Free Trade Agreements: In the Context of Article XXIV of the GATT 1994," in M. Matsushita and A. Dukgeun, eds., *WTO and East Asia: New Perspectives* (London: Cameron May, 2004); and Mitsuo Matsushita, Thomas J. Schoenbaum, and Petros C. Mavroidis, *The World Trade Organization: Law, Practice, and Policy* (New York: Oxford University Press, 2003), pp. 341-371.

[21] On the strategy of selective liberalization see, for example, Keidanren, *Urgent Call for Active Promotion of Free Trade Agreements – Toward a New Dimension in Trade Policy*, Policy Proposal, Tokyo, 18 July 2000, ¶2.d.

[22] On these figures see Saadia M. Pekkanen, Mireya Solis and Saori N. Katada, "Trading Gains for Control: International Trade Forums and Japanese Economic Diplomacy." (forthcoming, *International Studies Quarterly*).

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[26] Kenichi Kawasaki, "A US-Japan Free Trade Agreement Simulation," 13 March 2003 (available online at http://www.rieti.go.jp), esp. Table 1 (Macroeconomic Impact) and Table 2 (Impact on Industry Structure).

[27] US-Japan Business Council (USJBC), *2006 Policy Statement*, p. 3-8 (available online at http://www.usjbc.org).

[28] Ellis S. Krauss, "The United States and Japan in APEC's EVSL Negotiations: Regional Multilateralism and Trade Negotiations." In *Beyond Bilateralism: The US-Japan Relationship in the New Asia* Pacific, edited by Ellis Krauss and T. J. Pempel (Stanford, CA: Stanford University Press, 2004); and Michael Wesley, "APEC's Mid-Life Crisis? The Rise and Fall of Early Voluntary Sector Liberalization." *Pacific Affairs* Vol. 74, No. 2, 2001.

[29] Saadia M. Pekkanen, Mireya Solis and Saori N. Katada, "Trading Gains for Control: International Trade Forums and Japanese Economic Diplomacy." University of Washington, Seattle, manuscript, 2006.

[30] M. Taylor Fravel and Richard J. Samuels, "The United States as an Asian Power: Realism or Conceit?," MIT Center for International Studies, April 2005 (available online at http://web.mit.edu/cis).

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US-ASEAN Free Trade Agreements in the Context of Emerging East Asian Regionalism*

Written by

Seiji Naya

Emeritus Professor of Economics at the University of Hawaii
Visiting Senior Fellow of The East-West Center

and

Mike Plummer

Professor of Economics at Johns Hopkins, Bologna
Visiting Senior Research Fellow of the East West Center

1. Introduction

US trade policy had traditionally focused on multilateral liberalization, rather than bilateral or regional agreements, and while the United States did have some minor free-trade agreements (FTAs) in place, they were clearly exceptions to the multilateral rule.[1] However, in the 1980s, US policy began to shift. NAFTA was signed by the first Bush Administration and ratified under the first Clinton Administration (1994); the goal of creating a "Free Trade Area of the Americas" (FTAA) also emerged in the early 1990s.

The Trade Promotion Act (TPA), which had expired in 1994, was renewed in 2002. This provided a green light for bilateral, regional and multilateral negotiations. Since then, the United States has been pushing for trade (and investment) agreements at all levels *simultaneously*. This change in trade and investment policy arguably represents the most significant change in the US approach to commercial relations in at least 20 years, perhaps even since the creation of the GATT (and the rejection of the International Trade Organization in 1948).

Asia in general and ASEAN in particular have been important targets of this new thrust in US commercial policy. In October 2002, The United States announced The Enterprise for ASEAN Initiative (EAI) as a blueprint for establishing bilateral FTAs with ASEAN countries. There are two explicit conditions to take part in the EAI: (1) a Trade and Investment Framework Arrangement (TIFA) must be in place; and (2) all participants must be members of the WTO. Key ASEAN partners already are members of the WTO and have (bilateral) TIFAs in place. In August 2006, the United States negotiated a region wide US-ASEAN TIFA.

As the proposal to form a series of bilateral FTAs between the United States and ASEAN countries has become a reality, this study presents the economics of US-ASEAN free trade agreements. The United States already has an FTA in place with Singapore; it has had many rounds of negotiations with Thailand on a possible FTA (though nothing has materialized yet) and is currently negotiating with Malaysia. Other ASEAN countries could be next, though the recent US elections may dampen the regionalism trend for at least the next two years. Hence, evaluating the economic (and economic policy) stakes of this arrangement is important.

The outline of the paper is as follows: Section II provides a brief discussion of FTA issues, followed by Section III, where we examine trade of goods and services and foreign investment. Section IV covers commodity trade patterns in the context of US-ASEAN relations, while Section V presents applied statistical results of the determinants of US-ASEAN trade (using an augmented "gravity model"). Section VI briefly reviews Computational General Equilibrium (CGE) model estimates of the economic impact of various US-ASEAN bilateral FTAs. The final section presents a brief discussion of emerging East Asian integration followed by a concluding note on the role of the United States.

2. FTA Issues

The effect of integration is generally measured in terms of trade creation and trade diversion when tariffs and other trade barriers are eliminated. This measurement is obviously too narrow in terms of the actual effects of regional integration. If the driving force behind policy change is merely reducing tariffs to zero, and tariffs are already fairly close to zero, the net effect cannot be large. But modern FTAs, at least with the United States, go far beyond trade and trade barriers to span issues and concessions affecting foreign investment, e-commerce, intellectual property rights, telecom services, ICT, various key services, such as banking, consulting and legal services, as well as foreign investment laws. Simple tariff liberalization of manufacturing products, for which the GATT/WTO process has been so successful, is a small part of any "deep" bilateral FTA.

Modern FTAs will address many non-border issues that not only tend to increase flows of foreign direct investment (FDI) but also reduce many transactions costs of doing business. As was clearly demonstrated in the case of EU integration, a key area relates to harmonization of product standards, mutual recognition of product testing, mutual recognition of professional certifications and qualifications, trade and investment facilitation, and the like. Many of these areas are covered in the US-Singapore agreement and have been an important part of the bilateral US-ASEAN negotiations with other countries to date (and will be so in the future). Now, it is important to underscore that these areas generally imply the adoption of "best practices," reducing unnecessary costs, and bolstering competition, rather than creating a "fortress."

As is discussed below, trade and investment in goods and services will likely be affected fairly significantly, giving rise to income and employment changes and economic growth, lowering transactions costs and stimulating FDI inflows, particularly from outside the region. Increasing FDI inflows from the United States—and from other countries wishing to have duty-free access to the US market—are a key incentive for the ASEAN countries. This is an especially

important incentive, as most ASEAN countries have had disappointing inflows of FDI, particularly relative to main competitors, such as China. In many ways, modern FTAs will complement government efforts to restructure the economy to enhance its competitiveness and upgrade the industrial base to higher value added sectors.

As ASEAN countries move up the development ladder, they will be competing increasingly in areas in which economies of scale matter, including electronics, chemicals and auto-related production. They are currently restricted by the small size of each ASEAN market, and AFTA has probably done little to change this.[2] As ASEAN integration proceeds apace, exports will have duty-free (or close to duty-free) access to a regional market, but once again, the combined ASEAN market is not that big relative to the domestic markets of the United States, Japan and the EU. Hence, the EAI—as well as ASEAN+3 initiatives—could help competitiveness in these areas.

Moreover, the non-border issues that are covered in the agreement tend to make frequent reference to WTO protocols, disciplines and agreements, e.g., in the area of services, government procurement and intellectual property. In this sense, the forced-efficiency related areas are clearly "building blocs" to multilateral cooperation.

As a final point, we note that economic cooperation in Asia in general and ASEAN in particular spans both trade and financial cooperation, though process has certainly been more advanced in the former area. In terms of financial cooperation, ASEAN has been more active in working with the wider ASEAN+3 group. Examples include the Chiang Mai Initiative swap agreements, the Asian Bond Pool, and discussions related to an Asian Currency Index.

3. Trade of Goods and Services and Foreign Investment

In order to assess the potential impact of the EAI between the USA and ASEAN economies, we first consider trade and FDI flows between these countries. Exports and imports have grown substantially between the two regions. Two-way trade of the ASEAN-6 with the US rose from $51.5 billion in 1990to $134 billion in 2004, or 2.6 times (Tables 1 and 2). The US is the largest export market for ASEAN as a whole and for most individual countries (with the notable exception of Indonesia). Exports to the US comprised 15.2% of total exports of ASEAN-6 in 2004 though this share declined from 20% in 1990. In 2004, ASEAN's share of exports to Japan was 10.7%, down from 19% in 1990, and exports to China, 7.4%, rising from 1.7% in 1990. Intra-ASEAN exports rose to 22% from 19% during the same period. ASEAN imports from the US comprised 12.1% of total, as compared to 14.7% in 1990.

The ASEAN countries do constitute an important market for certain US exports, though obviously a fairly even distribution of the US trade destinations across Europe, the Americas and Asia, and the relatively small size of the ASEAN markets, naturally result in relatively low trade shares. Nevertheless, the US share of ASEAN exports has gone up to 5.7% in 2004 from 4.8% in 1990, while the US import share was 5.5% in 2004, which remained unchanged during the same period.

TABLE 1: Exports of ASEAN, Japan and the US (in % of World Total)

TO		THA	ASEAN-6	JPN	PRC	US	DA
Japan	1990	17.4	19.1	-	14.1	12.4	14.4
	2004	13.9	10.7	-	12.4	6.7	9.9
US	1990	22.7	19.8	31.7	10.6	-	22.0
	2004	15.9	15.2	22.7	21.1	-	17.9
China	1990	1.2	1.7	2.1	-	1.2	5.1
	2004	7.3	7.4	13.1	-	4.3	12.6
Thailand	1990	-	3.6	3.2	1.3	0.8	2.2
	2004	-	3.3	3.6	1.0	0.8	1.8
ASEAN-6	1990	11.5	19.6	11.5	5.8	4.8	11.0
	2004	17.9	21.7	12.3	6.3	5.7	10.8
Dev. Asia	1990	22.3	35.1	31.3	48.3	15.5	33.3
	2004	40.8	47.8	48.5	33.4	19.0	42.8
World($mill)	1990	22,805	141,025	287,678	69,478	393,106	451,900
	2004	97,408	519,103	565,487	593,232	816,385	1,944,400

Source: IMF, *Direction of Trade Statistics, 2005.*

TABLE 2: Imports of ASEAN, Japan and the US (in % of World Total)

TO		THA	ASEAN-6	JPN	PRC	US	DA
Japan	1990	30.6	23.5	-	13.4	18.0	21.0
	2004	23.6	15.9	-	16.8	8.7	16.0
US	1990	10.7	14.7	22.5	10.7	-	15.2
	2004	7.6	12.1	14.0	8.0	-	9.3
China	1990	3.4	2.9	5.1	-	3.2	7.7
	2004	8.6	9.1	20.7	-	13.8	11.9
Thailand	1990	-	1.7	1.8	0.7	1.1	1.2
	2004	-	3.7	3.1	2.1	1.2	2.4
ASEAN-6	1990	12.3	15.6	11.9	5.5	5.6	9.8
	2004	14.6	22.1	13.5	10.7	5.5	13.5
Dev. Asia	1990	27.7	30.0	28.9	35.1	20.2	30.7
	2004	36.1	44.5	45.3	37.6	27.8	42.4
World($mill)	1990	33,741	159,870	235,307	58,632	517,020	467,800
	2004	95,353	454,809	454,816	561,442	1,524,530	1,874,850

Source: IMF, *Direction of Trade Statistics, 2005.*

In terms of trade balances, The United States has a merchandise trade deficit with the ASEAN-6 countries, which rose from $9.9 billion in 1990 to $37.9 billion in 2004 (5.4% of total US deficit in that year). However, the United States has a significant trade surplus in the area of services (Table 3). The growth rate of US exports of services to ASEAN countries was higher than the global average. Likewise the US had a surplus in private services trade with ASEAN ($5.65 billion in 2002).

Although the surplus in services is not sufficient to balance the deficit in the merchandise account, the origins of the trade deficit in the United States—or any country for that matter—are macroeconomic in nature. Of greater interest to this region, rapid economic growth in ASEAN (pre- and post-Crisis) has provided myriad new market opportunities for US exports and investors abroad. ASEAN countries have generally reverted to the pre-Crisis growth trend, and the economic expansion over the past several years has been far greater than the global average, with future prospects being quite bright (see, for example, ADB, *Asian Development Outlook 2006*: Update, http://www.adb.org, published September 2006). In addition to the potential "growth effect", ASEAN could easily become an even more attractive destination for US FDI in the short- and medium-term for other reasons, such as AFTA, which reduces considerably transactions costs associated with using ASEAN as a production hub.

TABLE 3

A: Trade in Commercial Services: US, ASEAN and Selected Other Economies (US$ millions), 2002

	Exports	Imports	Balance
World	1,570,100	1,545,500	24,600
US	272,630	205,580	67,050
Japan	64,909	106,612	(41,703)
Indonesia	5,369	15,950	(10,582)
Malaysia	14,753	16,248	(1,495)
Philippines	3,029	4,225	(1,196)
Singapore	26,946	20,551	6,396
Thailand	15,232	16,573	(1,341)
ASEAN-5	65,329	73,547	(8,218)
China	39,381	46,080	(6,698)

B: US Trade in Private Services with: (US$ millions), 2002

	Exports	Imports	Balance
World	279,495	205,234	74,261
Japan	29,688	17,312	12,376
Indonesia	1,021	285	737
Malaysia	1,142	498	644
Philippines	1,514	1,274	240
Singapore	5,766	2,070	3,697
Thailand	1,139	810	329
ASEAN-5	10,583	4,936	5,647
China	6,073	4,136	1,937

Source: US Department of Commerce, Bureau of Economic Analysis

4. Foreign Direct Investment

Foreign direct investment inflows are paramount to an outward-looking development strategy in the contemporary global economy. FDI brings in new (non-debt creating) capital flows, foreign exchange, easy access to foreign markets and technology transfer. Regional economic integration accords such as free-trade areas can promote FDI inflows through reductions in transactions costs (be they border- or non-border in origin), as well as creating a more stable environment and internal "policy competition".[3]

Over the years, American firms have invested a substantial amount, second only to Japan, in ASEAN countries. Table 4A and 4B present the stock and outflows, respectively, of US FDI to the world, ASEAN and China for selected years. The world total of US FDI stock (or position) increased tremendously over this period, growing from $430 billion in 1990 to $1.8 trillion in 2003. Taking the ASEAN region together, we find that the stock of US investment in the ASEAN-5 countries came only to about $88 billion in 2003, 4.9% of the US total. Of the ASEAN total, 66% is in Singapore. This is followed by $10.4 billion in Indonesia and $7.6 billion in Malaysia and $7.4 billion in Thailand. Since the Asian Crisis US FDI outflows to ASEAN have varied considerably. We should note that total FDI inflow into ASEAN from OECD countries has also declined sharply from $19 billion in 1995 to $9.2 billion in 2004 (Table 5). Indonesia, in particular, has had a substantial and continuous negative inflow of FDI since 1999.

US investment in the ASEAN countries has been somewhat disappointing to the region's officials in both relative and absolute contexts. Considering the inherent benefits of FDI, the priority placed by ASEAN countries on luring FDI to the region, and the critical role of policy in determining FDI, economic cooperation, by lowering transaction costs associated with FDI, could significantly improve incentives for US FDI in the region.

As in the case of trade, the sectoral distribution of FDI is an important indicator of the nature of any bilateral economic relationship. In Indonesia, investment in the mining sector—especially petroleum—dominates US FDI, accounting for 79 percent of the total stock in 2003.

The story is different for Malaysia, the Philippines and (to some extent) Thailand, where manufactures tend to account for most of US FDI. Almost two-thirds of the stock of US FDI in Malaysia was in manufactures in 2003, and the vast majority of this investment (85 percent) is in the area of computer and electronic products, almost on par with the bilateral trade share in this sector. US FDI in the Philippines is somewhat less concentrated; in 2003 more than one-half of the stock of US investment in the Philippines was in manufactures, and 37 percent of manufacturing FDI flows went to the computer and electronics sector. Over time, the share of US manufacturing FDI in the Philippines has been roughly unchanged from one-half in 1993.

Thailand is somewhat of an intermediate case between Indonesia on the one hand and Malaysia-Philippines on the other. In 2003 slightly less than half (42 percent) of US FDI in Thailand was concentrated in manufactures. One-fourth of manufacturing FDI was in computer and electronics, while chemicals constituted approximately one-third of the total. However, it is interesting that US FDI in the electronics sector actually grew faster than that in any other ASEAN country, increasing an impressive three-and-a-half fold from 1998.

5. Commodity Trade Patterns and the EAI

ASEAN countries have been able to increase the share of manufactured goods in their total exports, and the US market has been playing a major role in this process. Exports of manufactures comprise from 69% (Indonesia), 78% (Thailand) to 91% (Malaysia) of their total exports. Electronics and electronic machinery have emerged as the dominant sector for the exports of Malaysia, the Philippines and Thailand, as well as being the most dynamic area in Indonesia. The most important component of bilateral trade tends to be in the general area of electronics and machinery (SITC 7) for all countries, with apparel being important also for Indonesia and the Philippines. These products are part of the "new economy," where hardware and software meet. Hence, policies geared toward trade in these goods will be increasingly interlinked with other areas, including intellectual-property-related issues. Electronics exports of the EAI are being driven to no small degree by external demand in the US market, as well as US FDI flows.

TABLE 4: US FDI Outward Position in and Outflows to ASEAN and Selected Asia, Selected Years 1990-2003

A: US FDI Stock in ASEAN (Historical-Cost Basis, US$ millions)

	1990	1997	2000	2003
All Economies	**430,521**	**871,316**	**1,316,247**	**1,788,911**
Indonesia	3,207	6,729	8,904	10,387
Malaysia	1,466	6,530	7,910	7,580
Philippines	1,355	3,219	3,638	4,700
Singapore	3,975	18,026	24,133	57,589
Thailand	1,790	4,332	5,824	7,393
ASEAN-Total	**11,793**	**38,836**	**50,409**	**87,649**
China	354	5,150	11,140	11,877

B: US FDI Outflows to ASEAN and China (US$ millions)

	1990	1997	2000	2003
All Economies	**30,982**	**95,769**	**142,627**	**151,884**
Indonesia	691	21	683	72
Malaysia	175	733	1,787	763
Philippines	177	107	480	(325)
Singapore	620	3,697	3,688	5,699
Thailand	316	(16)	722	(560)
ASEAN-Total	**1,979**	**4,542**	**7,360**	**5,649**
China	30	1,250	1,817	1,540

Source: US Department of Commerce, Bureau of Economic Analysis

TABLE 5: OECD FDI Outflows to ASEAN (US$ millions)

	1995	1999	2002	2003	2004
ASEAN-5					
Indonesia	4,346	(2,745)	(1,513)	(597)	1,046
Malaysia	4,178	3,895	3,203	1,104	2,074
Philippines	1,478	1,725	1,111	150	57
Singapore	7,206	8,550	2,030	5,625	5,378
Thailand	2,068	6,102	900	1,466	656
Total	**19,276**	**17,527**	**5,731**	**7,748**	**9,211**
China	**35,849**	**28,753**	**49,308**	**53,510**	**60,600**

Source: Asian Development Bank Outlook 2005

TABLE 6: Structural Change of ASEAN and China with US (Spearman Rank Correlation Coefficients, 3-Digit SITC, 1990s)

	US Imports		US Exports	
	1990-95	1990-99	1990-95	1990-99
ASEAN				
Indonesia	0.476	0.307	0.692	0.524
Malaysia	0.542	0.382	0.774	0.614
Philippines	0.474	0.301	0.751	0.592
Singapore	0.620	0.400	0.857	0.741
Thailand	0.701	0.547	0.766	0.638
Viet Nam*	NA	0.097	NA	0.366
China	0.887	0.828	0.662	0.513

* For US trade with Viet Nam, 1995-1999
Source: Asian Development Bank Outlook 2005

The US market will likely be more important in the future as the ASEAN economies mature and diversify.

It is useful to capture the dynamics of changing pattern of EAI trade by examining the extent to which commodity composition or make-up changed between the USA and ASEAN countries. We attempt to answer this question by examining the correlation of disaggregated commodity exports overtime. We have used the Spearman Rank Correlation Coefficient (SRCC) technique. The value of this correlation range from –1 to +1: perfect correlation would be unity while complete lack of correlation is zero. Using 3 digit SITC trade data of the US, the rank correlation coefficients are computed and given in Table 6.

US imports from Indonesia, Malaysia and the Philippines (which are the latter's exports to the US) changed significantly over the 1990s; SRCC's estimates are 0.307, 0.382 and 0.301, respectively. Hence, when ranking the exports of Indonesia to the United States in 1990 and 1999, we find that the correlation comes to only about 30 percent, suggesting considerable change. In fact, this change is even more pronounced than in the case of any other Asian country included in the sample with the exception of Viet Nam, with which the United States was just beginning to establish normal diplomatic and, hence, a trade relationship.

Regarding the change in structure of US exports to the ASEAN countries, one derives far less change. To some degree this is to be expected; as noted above, the United States is an advanced industrial economy and one would expect its comparative advantage to be fairly stable.

Since the EAI negotiations are being done bilaterally and not with ASEAN as a whole, there is a

possibility of facing negative effects of trade diversion for those countries that are excluded from FTA. The degree to which such countries are affected will depend critically on how much overlap there is between their exports and those of the countries that succeeded in obtaining preferential treatment through an FTA (and of course, the level of commodity-level protection in the export market).

We have attempted in our calculations to determine to what extent are EAI exports similar to each other. One way to answer this question is compare the ranking of the structure of exports of two countries (to a specific market) for the same year. A high estimated SRCC value would, therefore, suggest significant export overlap, whereas low values would mean not much competition at between the paired countries.

We do this at the 5-digit SITC level (2881 commodities) for the exports of Indonesia, Malaysia, the Philippines and Thailand to the US market for the years 1995 and 1999. The results are presented in Table 7. The SRCCs fall in the 0.174 (Malaysia-Philippines, 1995) to 0.277 (Indonesia-Thailand, 1999) range. While we have no yardstick by which to deem what constitutes a "high" SRCC and a "low" SRCC, these values suggest that there is not a great deal of overlap across countries. However, it is noteworthy that "competition" between Malaysia and the Philippines in the US market has been rising over time, while there has been less overlap between the Philippines and Indonesia. Competition between Thailand and the Philippines has risen and is relatively high, but it has fallen with respect to Malaysia and Indonesia. But in sum, while the SRCC calculations suggest that some but not a considerable degree of export overlap exists between the EAI countries—and, hence, the risk of trade diversion due to being left out of a free-trade area does not appear particularly high.

TABLE 7: Correlation of ASEAN and China Exports to US (Spearman Rank Correlation Coefficients, 5-Digit SITC)

		Indonesia	Malaysia	Philippines	Thailand	China
Indonesia	1999	-	0.2460	0.2010	0.2100	0.3000
	1995	-	0.2128	0.2680	0.2770	0.4040
Malaysia	1999	0.2460	-	0.1910	0.1870	0.2790
	1995	0.2128	-	0.1740	0.1990	0.3170
Philippines	1999	0.2010	0.1910	-	0.2630	0.3620
	1995	0.2680	0.1740	-	0.2310	0.3690
Thailand	1999	0.2100	0.1870	0.2630	-	0.4000
	1995	0.2770	0.1990	0.2310	-	0.4010

Source: OECD, International Trade Statistics, 2003; Authors' Calculations.

We have also compared ASEAN exports to the US with Chinese exports to the US. If there is considerable overlap, then the EAI might even make more sense to ASEAN, that is, as a means of gaining a preferential edge over China's exports in the US market. To answer this question, we once again perform SRCC calculations, comparing the rank structure of Chinese exports and that of the ASEAN countries to the US (and other key OECD, not shown) markets. The results are also presented in Table 7. In many ways the results are surprising and do not assuage the ASEAN fears of the Chinese threat. Though the results are not recorded in the table, relative to intra-ASEAN competition in OECD markets, the SRCC values are high and grew over time not only in the US market but also in other destinations overlap is rising in every country. Thus, the increasing competition from China might suggest another motivation for the EAI, that is, create a policy advantage over China in the US market.

6. Applied Statistical Analysis of US-ASEAN Trade: A Gravity Model approach

There are two models that are often used to test economic impact of FTAs, the gravity and computerized general equilibrium, CGE models. Trade between countries is affected by variety of factors, such as the size of GDP, distance between them, relative factor endowment, language barriers and the existence of a regional trading arrangement. Given these factors, is there a special trade relationship between ASEAN and the US? We pick up this trade bias in our gravity model through an ASEAN binary or "dummy" variable. If the ASEAN binary variable is positive and statistically significant, it is viewed as a trade bias in favor of trade with ASEAN. If this binary variable is rising (falling) over time, it means that the trade bias is increasing (decreasing). We run our entire gravity model for US trade with ASEAN, as well as for EU trade with ASEAN as a "control country".

After controlling for the usual factors, such as size, wealth and distance, the results show that there exists a bias toward bilateral trade in US-ASEAN trade patterns. Indeed, we find that the US-ASEAN relationship is special, in that the partnership adds extra explanatory power to the determinants of trade flows. [4]

However, upon separating out individual ASEAN countries, this special relationship does not quite materialize in the case of Indonesia (except for a few years); exists only to some degree in the case of Malaysia but appears to be declining over time and with a good deal of volatility; and is most notable in the cases of Thailand and the Philippines but, again, the magnitudes and, in the case of the Philippines, statistical significance, decreases over time. We suggest that this decrease in bias toward bilateral trade could be a result of the fact that the United States (and the EU) have been creating FTAs and other bilateral accords with ASEAN's competitors. Or it could be that ASEAN countries have been losing competitiveness for other reasons, e.g., the emergence of China and India as major competitors, or local structural factors. In any event, the EAI would certainly help remove any associated trade diversion from regional agreements, give the region a level playing field in the US market, and even give it a competitive edge over such formidable competitors as China.

7. CGE Estimates of Economic Impact of FTA

Dealing with US-ASEAN FTA issues, a natural question to ask is, what is the likely economic effect of EAI? How large will be the associated gains? Such an assessment is not a simple task. The Computer Generated Equilibrium Model (CGE) approach has become a standard tool in estimating the FTA impact. Most of these models are based on the GTAP data and specifications.

CGE estimates of GDP impact on ASEAN countries, the US and Japan for various FTA groupings are summarized in Table 8. The impact of bilateral FTAs between the US and ASEAN countries is shown in Table 9. From these tables, several observations are worth noting. First, excluded ASEAN countries from various FTAs invariably suffer a decline in GDP, probably resulting from trade diversion. For example, the Singapore-US FTA yields an

increased GDP for Singapore, but a negative effect on all excluded ASEAN countries. The same result is shown in the Singapore-Japan FTA. A large impact in relative terms comes from a North East Asian FTA. In other words, if an FTA involving China, Korea and Japan is formed, it will have a negative impact on all ASEAN countries.

TABLE 8: Effects of Various FTAs on EAI Countries (Equivalent Variation Basis; Percent of GDP)

		Indonesia	Malaysia	Philippines	Thailand	Singapore	US	Japan
FTAs:	Singapore-US	-0.02	-0.04	-0.05	-0.01	0.66	0.00	0.00
	Singapore-Japan	-0.02	-0.35	-0.08	-0.09	4.06	0.00	0.00
	Japan- Korea	-0.01	-0.07	-0.05	-0.03	-0.07	-0.01	0.01
	Japan-SK-China	-0.15	-0.70	-0.35	-0.21	-0.87	-0.02	0.25
	ASEAN+3	0.69	1.24	-0.19	1.00	4.12	-0.03	0.34
	Pacific 5 (1)	-0.02	-0.13	-0.06	-0.02	0.92	0.02	-0.01
	Global Free Trade	1.31	6.05	3.42	2.57	6.94	-0.05	0.98

Notes: 1. Pacific 5= FTA between Australia, Chile, New Zealand, Singapore and United States

Source: Scollay, Robert and John P. Gilbert, *New Regional Trading Arrangements in The Asia Pacific*. (Washington, DC: IIE, May 2001)

TABLE 9: CGE Estimates of Nominal GDP Changes by Bilateral FTAs between the US and ASEAN countries (%)

	Indonesia	Malaysia	Philippines	Thailand	Singapore
ASEAN	2.75	0.46	3.1	0.66	0.72
US	-0.02	0.03	0.01	-0.01	0.07

Source: Scollay, Robert and John P. Gilbert, *New Regional Trading Arrangements in the Asia Pacific*. (Washington, DC: IIE, May 2001)

Second, one striking feature of the FTA results is how small the GDP gains are for almost all countries and cases. While the signs might be correct, the magnitude of GDP impact is small and even in some instances, insignificant. In the case of ASEAN countries, this is especially strange, considering their growth experiences, when they shifted to open and outward development strategies in the past. In the case of the United States, it is understandable that given the size of the US economy and the fact that the United States is the most open large economy in the world, the impact is not going to be significant. But it is somewhat surprising that the impact on the United States is either zero or negative. Only in the case of Pacific-5 FTA and US-Thailand FTA, there is a GDP gain of 0.02% and 0.07%, respectively.

There are a few exceptions, especially in the case of global free trade, in which Malaysia and Singapore would have a growth rate higher than 6%. But remember the model used reflects instant and automatic adjustment when FTAs go into effect. On the other hand, in practice it may take a few years, or even longer, for the adjustment to be completed when FTAs are instituted and prices are adjusted accordingly. Therefore, the growth rate shown in tables may have to be divided by a few years to have the annual increase.

In view of such a small gain, or even negative gain shown in the results, one might question whether it is worth the time and energy of engaging in the difficult processes of FTA negotiations and the reforms and structural adjustments a country must make.

Here we would like to stress that a major shortcoming with economic modeling in the area of estimating the economic effects of regional trading agreements—as well as other commercial policy initiatives—is that ”dynamic” economic effects, such as changes in investment flows, technology transfer and the like, as well as policy-related issues, are not adequately incorporated. Also, trade-in-services, an increasingly large part of total trade is not included into most models. These models generally focus on the one-time effect of a price change induced by an FTA; such a scenario would no doubt have limited long-run effects on associated economies. However, policy changes and dynamic benefits of regionalism have long-run effects that build up over time and tend to be “path dependent”.

The review of empirical work on CGE models finds that trade creation dominates trade diversion. This is good. Also, welfare gains are larger when models incorporate such items as increasing returns, imperfect competition, technology transfer, and dynamic effects, e.g. capital accumulation and total factor productivity. The review also shows the impact of international capital mobility is more important than trade liberalization. We are all aware that the latter has a big impact on influencing the former. However, CGE models that incorporate these missing components are not readily available, and if available, become very complicated. But it is sufficient to note that the FTA results are likely to be substantially larger than what is found in these studies.

8. Emerging East Asian Economic Integration

Intra-ASEAN trade has been rising, though slowly, and presently comprises 22% of total trade. But ASEAN trade with other developing Asian countries, such as China and Korea, has been growing more rapidly. This intra-regional trade of developing Asian countries comprises 46% of total (Tables 1 and 2). In other words, intra-regional economic integration in East Asia has been increasing substantially. Moreover, this trend is market-driven, rather than policy-driven, as was arguably the case in the early years of EU integration.

When the financial crisis erupted in 1997 and spread to other Asian countries, many believed that ASEAN would fall apart. But instead of full retreat, ASEAN economic cooperation has been increasing in depth and breadth. Two important policy decisions have emerged. First, to map out a long-term vision, ASEAN declared ASEAN Vision 2020. Subsequent ASEAN summits have adopted resolutions to strengthen the ASEAN integration process with the eventual establishment of the ASEAN Economic Community (AEC), which is now slated to be completed by 2015 for all but the transitional ASEAN Member Countries.

The main priority of the Ha Noi Plan of Action in December 1998 was to develop a framework for the Vision 2020. Out of this process came recommendations to: (1) speed up the AFTA process and ancillary integration initiatives (e.g., the ASEAN Investment Area, services trade liberalization); (2) strengthen further the technical capacity of the ASEAN Secretariat; (3) implement the ASEAN Surveillance Process (ASP). The Bali and Vientiane ASEAN Summits in 2003 and 2004 began to strengthen the concept of the AEC. It is likely that the AEC is seen in ASEAN as critical in order to make sure that an ASEAN identity is not lost but instead strengthened when it begins to integrate with its larger Asian partners.

Second, the crisis gave major impetus to the creation of ASEAN Plus Three- Korea, China and Japan (APT). After the Crisis, Korean Prime Kim Dae Jung proposed the East Asian Vision Group, with a goal of creating East Asian free trade integration. At the 5th ASEAN+3 (APT) Summit in 2001, the group later proposed a move to establish an East Asian free trade association and holding the East Asian Summit in Kuala Lumpur. Also, Japan proposed the Asian Monetary Fund to assist Asia in future times of need. The proposal eventually led to the creation of the Chiang Mai Initiative (discussed above), which was a financial arrangement in the form of currency swap, supported by all of ASEAN, China and Korea.

The East Asian Summit, which was held in December 2005 in Malaysia and could become a regular event, attempted to lay the foundation of a future East Asian economic community. The nature and participation are important, as they would influence the direction of East Asian integration. There was a considerable level of disagreement among ASEAN countries, with even fear of the summit being cancelled. In 1990, when then Prime Minister Mahathir, who initially proposed the idea of a special summit, it included only the current APT countries, and also it was viewed as inward looking. In fact, it was reported that Malaysia and China supported the participation of only APT countries in the upcoming summit. On the other, Indonesia, Singapore and Viet Nam supported the involvement of a wider grouping, including Australia, New Zealand and India.

But to credit ASEAN, as often done in the past, they came up with an amicable solution which would allow the participation of other countries by signing ASEAN Treaty of Amity and Cooperation and meeting two other conditions. This has opened the door for India, Australia and New Zealand to attend, forming the "ASEAN+6". This inclusion has also distinguished the East Asian Summit from the regular APT meetings. One major absentee was the United States. It is not very clear if the United States was invited or refrained to attend voluntarily. Even if invited, the question is if the United States would have signed the Treaty of Enmity and Cooperation.

The East Asian Summit touched on a number of important issues, from cooperation in environment, energy, poverty eradication, narrowing of development gaps. However, little concrete discussion on East Asian integration was brought up. The summit appears to be development of, but not successor to ASEAN+3. They have agreed to hold the summit annually and in conjunction as ASEAN summit in same location, chaired by ASEAN country chair. This will assure ASEAN as the driving force of East Asian Summit.

There are however many complications deriving from vastly different development level, different political systems and the lack of leadership. It is therefore very difficult to conjecture the modalities and future direction of East Asian integration. However, the United States should not underestimate the potential of East Asian regionalism. In the past, the United States did not have to compete with other Asian powerhouses for policy influence in the region. Japan and Korea were committed multilateralists, and China had not yet emerged as a major economic player.

In the start of the 21st century, however, the policy situation has changed considerably. Japan, China and Korea have become active in proposing new FTAs in Asia, either bilaterally or under the APT umbrella, which could compound the existing trends of intra-Asian trade. China is now a regional powerhouse and is doing the same. Both have launched negotiations with ASEAN regarding eventual FTAs. China and ASEAN even began their "early harvest program" as a sort of down payment in the FTA negotiation process in 2004. If the East Asian Summit in the future

succeeds in advancing regional integration, through FTAs and/or closer financial cooperation, it is likely that these accords will be open and outward looking; therefore, the US should not fear Fortress Asia. Still, the United States could be affected negatively by trade diversion and could find itself losing influence. That suggests that the US would lose market share in the world's fastest growing market.

In sum, we would support pushing forward with the EAI. As presented in this paper, EAI is beneficial for not only ASEAN but also the United States. From a policy point of view, since ASEAN is a key partner of various integration efforts taking place in Asia, EAI will allow the US to participate indirectly in this process.

The second avenue for US involvement has been participation in APEC. APEC Summits, for example, allow for the meeting of APEC leaders for discussions relevant to emerging issues in economics and other areas. It does not have the formal mechanism of integration. Moreover, the Bogor Vision, which at the 1994 Summit in Bogor, Indonesia committed APEC to forging a region of "open trade and investment" by 2010 (2020 for developing economies), has a long way to go before being realized. In fact, if by "open trade and investment" APEC means a nondiscriminatory region of free trade and investment, the Vision is out of reach. This has led many to question the credibility of APEC, a sentiment that will no doubt be amplified as 2010 draws near.

But in November 2006 the United States government came out in favor of studying the possibility of creating an Asia-Pacific FTA, which would presumably be a "hard" (i.e., reciprocal) version of the APEC Bogor Vision. While the approach at this point is for mere study, it does appear to suggest that the United States does see East Asian regionalism as a trend in which it would like to be included directly, particularly as a competitor to the East Asian FTA proposal. It will be interesting to see how these strategies will play out. Still, the results of the recent midterm elections, in which the Democrats have retaken both the House and the Senate, might not bode well for the future of FTAs in the region (or elsewhere), given a higher propensity for Democrats to be more skeptical of trade liberalization.

As a final note, it is important to stress that all region-wide proposals appear to be based on "open regionalism," that is, a means to increasing international trade and investment, rather than creating regional "fortresses". The boom in international trade over the past few years, as FTAs are being implemented, offers *prima facie* evidence of the compatibility of these arrangements with the global trading system. Still, regionalism/bilateralism will always be a potential threat to multilateralism; hence, the Doha Development Agenda should remain an important priority for all parties. With the results of the November 2006 US election and the prospects of a tough election year in 2007 in Europe (especially France) and elsewhere, it will take a considerable amount of political will to push the Doha process forward. The fight will be difficult but of utmost importance to the health of the global trading system.

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[1] These agreements included an FTA with Israel in manufactures (1985), the Caribbean Basin Initiative (1983) and, in 1989, the US-Canada FTA. While the latter is arguably not "minor," *de facto* it was in that 70 percent of US-Canada trade was already free, and the economies were highly integrated.

[2] For example, as of March 2006, the estimated use of preferences within the AFTA framework (under the CEPT) came to only approximately 5% of ASEAN trade.

[3] By "policy competition" here we imply that countries within a free-trade area will have an incentive to adopt best-practices, promote a low-cost business environment, and embrace greater transparency if they are to compete effectively for FDI flows within a given trade area.

[4] See chapter 3 in Naya and Plummer, *The Economics of the Enterprise for ASEAN Initiative*, for further discussion on this topic.

"A MEGA JUMBO-JET": Southeast Asia's Experiments with Trade and Investment Liberalisation

Written by

C. L. LIM

Associate Professor, Faculty of Law
National University of Singapore

This paper is about trade design and legal doctrine. It describes the Association of Southeast Asian Nations (ASEAN) Free Trade Area, current efforts towards building an ASEAN Economic Community, and also ASEAN's wider aspirations in seeking to build a "mega jumbo-jet" with ASEAN as the fuselage, East Asia as one wing and South Asia the other through a complex network of free trade agreements (FTAs). Our attention is drawn principally to the formation of regional trade agreements under which no MFN doctrine applies at all; thereby allowing further, smaller FTAs to be formed in the shadow of such regional agreements under Article XXIV of the GATT-WTO Agreement. More than that, the recent innovation of bilateral Tariff Reduction and/or Elimination Agreements under the Early Harvest Programme (EHP) not only creates an exception to MFN, it replaces the idea of having some multilateralised concessions as between all the members that make up ASEAN as a whole. In that sense, there is no "ASEAN-China deal" as such, at least not substantively, beyond a multilateral framework under which the real deals get done separately and bilaterally. ASEAN's FTA policies are therefore used to illustrate, and to test, the claim today that the MFN doctrine has fallen into desuetude. For example, is this loosely assembled regional organisational approach the direction which future FTAs might take? How large a scope or area might such regional FTAs cover? Should this be considered undesirable somehow? How might we refashion trade law doctrine so as to promote the "multilateralisation" of FTA concessions instead – a function traditionally performed by the MFN doctrine?

1. Introduction

Nations enter into FTAs for a variety of reasons. There is still an absence of consensus as to whether FTA policies should be analysed primarily in economic or strategic terms. This is

especially so in relation to the choice of FTA partners. Is the choice of China as an FTA partner by ASEAN to be measured primarily in strategic terms, in trade terms or both?[1] Similar questions might be asked, for example, in relation to the United States-Singapore FTA (USSFTA). As Singapore's then trade minister put it in relation to the USSFTA "[a]part from the benefits of increased trade and investment…both sides wanted the agreement for strategic reasons…[i]t also signals the U.S.'s long-term commitment to Asia".[2]

But taking a legal and institutional perspective could also yield important insights. From an ASEAN perspective, one observer has recently highlighted the danger of China-India trade "bypassing" Southeast Asia, a danger which ASEAN's current process of "economic integration" can perhaps address by adding something which neither India nor China at present has – a reliable legal-institutional framework for China-India trade.[3] Yet others have focused on the variety of dispute settlement procedures which a range of FTAs currently employ and the potential weaknesses of such diversity in terms of their efficacy.[4] Elsewhere, multilateralists point out that smaller and poorer nations are at a disadvantage in bilateral negotiations instead, and that policy questions concerning the equitable distribution of global wealth can therefore only be addressed multilaterally, and not through a global proliferation of FTAs.[5]

Viewed from a legal and institutional perspective, do ASEAN's FTAs contribute – i.e. do they add positively - towards the "architecture" of trade and investment? Parts II and III of this paper describe the trade and investment policy-aims and behaviour of the countries of Southeast Asia, acting both individually and collectively. Part IV deals with the impact of these policies on the global trading system, particularly as they might affect multilateralised trade concessions through the Most Favoured Nation (MFN) device.[6]

2. ASEAN's Path to Southeast Asian Economic Integration

We consider the history of ASEAN economic integration in this part while turning in the next part (Part III) to ASEAN's FTA negotiations with trading partners outside ASEAN.

A. Background

ASEAN's history in this regard is largely that of the creation of the ASEAN Free Trade Area (AFTA) and beyond.[7] Some have argued that the true impetus for AFTA arose out of the 1997 Asian financial crisis.[8] Notable amongst the official statements of the period are the ASEAN Heads of Investment Agencies' 1998 "Statement on Bold Measures". However true this observation might be in identifying a further impetus for the strengthening of AFTA, the history of AFTA pre-dates the financial crisis. AFTA was initiated in 1992 at the Fourth ASEAN Summit held in Singapore.[9] Looking back at the financial crisis with the benefit of hindsight, some observers have criticised AFTA for having been conceived during a period of hubris; a time when there was both much talk of "Asian Values" as well as a "precipitate" expansion of ASEAN membership.[10] Others emphasize ASEAN's resolve during this period:[11]

> After all, ASEAN has announced an ambitious and far-reaching ASEAN Vision 2020 and, amidst the crisis, undertook to proceed with its implementation with the

Hanoi Plan of Action.

In any event, the Ha Noi Action Plan saw the use of the term "ASEAN Economic Integration", based on an open regionalist model. The present Secretary-General of ASEAN, H.E. Mr Ong Keng Yong has also observed that:[12]

> [C]ollectively we are a market of 520 million with a combined GDP of US$580 billion and total two-way trade of US$781 billion (in 2000). In other words, ASEAN is about half the size of China in population and GDP. But we are a bigger trader than China; China's external trade in 2000 was only US$474 billion. ASEAN is the fourth biggest trader in the world after the EU-15, the US and Japan …[and]… all major economic powers in the world are our key cooperation partners.

We must not draw the wrong conclusions from this. Jusuf Wanandi, a veteran observer of ASEAN's movements has cautioned recently that ASEAN cannot in and of itself become the driving force behind the East Asia Community-building process. This is since "[i]t will take some years before ASEAN has enough strength to face and balance the North East Asian economies, which constitute…80% of the region's economy".[13]

Wanandi's point is well-taken but what is notable today is that the history of ASEAN free trade can no longer be viewed in isolation from ASEAN's more comprehensive ambitions not only to accomplish some considerable degree of trade liberalization, but also to pursue economic integration (the AEC) and to become a security and socio-cultural community with the two pillars of having (also) an ASEAN Security Community (ASC), and an ASEAN Socio-Cultural Community (ASCC).[14]

Recall that ASEAN's focus was not always on economic integration.[15] What is said here needs also to be viewed against ASEAN's larger geo-strategic, social, cultural and political backdrop – and which encompasses a vision of human security in Southeast Asia in the broadest, contemporary sense.[16] ASEAN in the aftermath of the Cold War was something of a security organization in search of a new identity and a new mandate. In the immediate post-Cold War period, some commentators had forecast the coming collapse of ASEAN. For them, ASEAN was an organization in search of a mission with the abatement of the historic Cold War threat of Soviet incursion into Southeast Asia.[17] ASEAN, they said, had cut its teeth battling the Vietnamese occupation of Cambodia, viewing this as the first realizable sign of the erstwhile USSR's ambitions in Southeast Asia. The lessons of cooperation were security-based in nature, and such a loose and indeed notoriously sluggish organization would falter in the absence of a common external threat. A principal culprit many pointed out is the cumbersome process of decision-making in ASEAN; namely, the *musyawarah* practice of consensus decision-making. This "ASEAN way" of decision-making has been something of an object of derision, especially on the part of external observers and skeptics within ASEAN.[18]

Following the Asian financial crisis, some saw hope for a new role for ASEAN. This was viewed against the backdrop of the economic and human challenges faced by the region following the severe effect the crisis had had on the Southeast Asian economies. But the doomsayers lingered on. According to them, the crisis was not so much an impetus to push ASEAN ahead but was instead merely a symptom of the malaise of ASEAN's domestic institutions, particularly the absence of sound regulatory institutions in Southeast Asia and the

inherent instability of ASEAN economies.[19] Corruption, the absence of transparency, nepotism and the like – these are the Southeast Asian characteristics that, even today, come quickest to mind.

ASEAN is not yet over that period of negative press coverage and negative popular public perception. But perhaps there is room for cautious optimism. Today, we see an ASEAN which has never been more energetic in its efforts to steer Southeast Asia to a secure position in an increasingly challenging global landscape. ASEAN is becoming more than both a security and an economic organization. Even with the grave threat of Southeast Asian-borne terrorism and religious extremism, and the grave economic divide between ASEAN's richest and poorest nations, the perception within ASEAN is one of cautious hope and optimism. Weathering the financial crisis has added a dose of reality, the diversion of foreign direct investment has added a sense of cohesiveness if not urgency in maintaining ASEAN as an attractive recipient of foreign direct investment (FDI), and the multiplicity and complexity of threats, the need that in turn creates for transnational political and regulatory cooperation, as well as the need to act as a singular, preeminent advocate of the Southeast Asian economies should cause us to take Southeast Asia seriously.

B. From the 1992 Inception of AFTA to the 1998 Ha Noi Action Plan

AFTA was initiated in 1992 through the Framework Agreement on Enhancing ASEAN Economic Cooperation, and the Common Effective Preferential Tariff Scheme (CEPT).[20] According to the 1992 CEPT Agreement, the original six ASEAN member states agreed to the elimination of quantitative restrictions (QRs) and other non-tariff barriers (NTBs) as well as to reduce tariff rates on intra-ASEAN trade in goods which meet the 40% ASEAN content requirement. They committed to a tariff reduction to the 0–5% range within 15 years, beginning 1 January 1993. Currently, more than 99% of the items on the inclusion list for the original six members have been brought down to that range. As for the newer members (Cambodia, Laos, Myanmar and Viet Nam), 66% of the almost 80% of total products which have already been moved into their inclusion lists are already within the 0-5% range.[21]

AFTA had taken one year to negotiate before signature in 1992. It precedes both NAFTA and the WTO Agreements. From its inception to the Ha Noi Plan of Action, the targets originally set for the achievement of the 0-5% tariff target for products which meet the 40% ASEAN content requirement in the case of the original six members were shifted twice, from the original target date of 2008 (i.e. 15 years from the inception of AFTA) to 2003 in 1994,[22] and again, from 2003 to 2002 in 1998.[23] According to the Ha Noi Action Plan, the current target dates for achieving the 0-5% range are 2006 for Viet Nam, 2008 for Laos and Myanmar and 2010 for Cambodia based on the "10 year" formula (i.e. 10 years from the date of their membership of ASEAN).[24]

(i) The Ha Noi Action Plan

At Ha Noi in 1998, during the Sixth ASEAN Summit, the ASEAN Ministers pushed forward the target date for the "completion" of AFTA from 2003 to 2002.[25] According to that target, tariffs on goods should by then have been brought down to no more than 5%. According to the

Preamble to Part II of the Ha Noi Action Plan, the aim of "economic integration" (dealt with in Part II) would be to create:[26]

> …a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities.

(ii) The "Two-Track" Approach

(a) Goods: The ASEAN Integration System of Preferences

For the goods trade, the Ha Noi Action Plan covered trade liberalisation, customs harmonisation, standards and conformity assessment as well as other means of trade facilitation.[27] A two-track approach was adopted for trade liberalisation as between the older and newer ASEAN members. The aim was to:[28]

a. Maximise the number of tariff lines whose CEPT tariff rates shall be reduced to 0-5% by the year 2000 (2003 for Viet Nam and 2005 for Laos and Myanmar);
b. Maximise the number of tariff lines whose CEPT tariff rates shall be reduced to 0% by the year 2003 (2006 for Viet Nam and 2008 for Laos and Myanmar); and
c. Expand the coverage of the CEPT Inclusion List by shortening the Temporary Exclusion List, Sensitive List and General Exception List.

The two-track approach was adopted in order to bridge the development gap between the various ASEAN Members in accordance with the Initiative for ASEAN Integration, ASEAN Ministers also agreed in Ha Noi to implement the ASEAN Integration System of Preferences, involving the extension of tariff preferences to the newer members of ASEAN by older, established members.[29]

(b) The Investment "Three-Prong" Strategy

To further the ASEAN Investment Area (AIA) through individual and collective action according to the agreed schedules and timetable,[30] a three-prong investment strategy was also adopted at Ha Noi comprising (1) cooperation and facilitation, (2) promotion and awareness, and the (3) AIA liberalisation programme itself. The central strategy, in paragraph 2.2.a of the Ha Noi Plan consisted of the abovementioned two-track approach. The two-track approach was taken both to coverage and time-lines so as to:[31]

> Immediately extend national treatment and open up all industries for investments. However, for some exceptions, as specified in the Temporary Exclusion List and the Sensitive List, these will be progressively liberalised to all ASEAN investors by 2010 or earlier and to all investors by 2020 in accordance with the provisions of the Framework Agreement on AIA.

This is followed by a non-exhaustive, illustrative list of policy objectives to realize ASEAN's

three-prong investment strategy.[32]

By and large the three-prong strategy seeks to further the regime created under the 1998 ASEAN Framework Agreement on Investment, the 1987 ASEAN Investment Treaty and its 1996 Protocol. Notable features of the 1998 Framework Agreement are the inclusion of pre-establishment rights for ASEAN investors,[33] exclusion of portfolio investments,[34] provision for Market Access in respect of all industries subject to exceptions,[35] National Treatment for ASEAN investors subject to a "Temporary Exclusion List" and a "Sensitive List",[36] and MFN treatment subject to waiver.[37] The Framework Agreement envisages National Treatment for ASEAN investors by 2010 and for all other investors by 2020, subject to exceptions.

The earlier 1987 ASEAN Investment Treaty had provided for investment screening,[38] MFN but not National Treatment,[39] the standards of "full protection" and "fair and equitable treatment",[40] what approximates the Hull standard of compensation,[41] and compulsory investor-State arbitration.[42]

(c) Services: Negotiation Coverage of All Services Sectors and Modes of Supply

As for services, a notable in-principle commitment in Ha Noi was to open up negotiations for all services sectors and all modes of services supply.[43] In addition, Part I of the Ha Noi Plan laid out a framework to strengthen ASEAN macroeconomic and financial cooperation.

C. The ASEAN "Bali" Concord II

This was followed up in 2003 by the Declaration of ASEAN Concord II of 7 October 2003 (Bali Concord II) comprising two general parts – a "Declaration" and "Framework".

(i) An "Open" ASEAN Community

Paragraph 1 of the declaratory part of Bali Concord II (hereafter, "Bali II Declaration") is a watershed in the evolution of ASEAN economic integration.[44] In declaring the establishment of the "ASEAN Community",[45] paragraph I states that:[46]

> An ASEAN Community shall be established comprising three pillars, namely political and security cooperation, economic cooperation, and socio-cultural cooperation that are closely intertwined and mutually reinforcing for the purpose of ensuring durable peace, stability and shared prosperity in the region…

Paragraph 2 drives home the capaciousness of the ASEAN Community concept:[47]

> ASEAN shall continue its efforts to ensure closer and mutually beneficial integration among its member states and among their peoples, and to promote regional peace and stability, security, development and prosperity with a view to realizing an ASEAN Community that is open, dynamic and resilient…

The notion of an "open" ASEAN Community is particularly notable, and paragraph 7 elaborates further, stating that:[48]

> ASEAN is committed to deepening and broadening its internal economic integration and linkages with the world economy to realize an ASEAN Economic Community through a bold, pragmatic and unified strategy…

Paragraph 9 – the "RTA paragraph" – reinforces an "open regionalist" ASEAN policy:[49]

> ASEAN shall build upon opportunities for mutually beneficial regional integration arising from its existing initiatives and those with partners, through enhanced trade and investment links as well as through IAI process and the RIA…

(ii) The "Framework"

The Bali II Declaration then goes on to state that the ASEAN members thereby "adopt" a "framework to achieve a dynamic, cohesive, resilient and integrated ASEAN Community" (hereafter, "Bali Framework"). Part "B" of this Bali Framework, entitled the "ASEAN Economic Community" (hereafter, "the Community"), states that:[50]

> The ASEAN Economic Community is the realisation of the end-goal of economic integration as outlined in the ASEAN Vision 2020, to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in year 2020.

The Community is premised upon a "convergence of interests", while employing "clear timelines" to "deepen and broaden economic integration efforts".[51] So there are two dimensions. Put simply, the underlying vision here is that of a perceived mutual interest amongst the ASEAN nations to further economic integration in a disciplined manner.

Paragraph 3 adds that the Community itself "shall establish ASEAN as a single market and production base".[52] One commentator has observed that:[53]

> Apparently, a single market is more than a common market, but how much more is an interesting question. The Single European Act describes it as "an area without internal frontiers in which the free movement of goods, persons, services and capital in ensured". Criticizing…this definition…[for being]…imprecise… [Lloyd]…defines a single market "as one in which the Law of One Price must hold in all goods, services and factor markets", which means that "there should be a single price in the regionwide market for every tradable commodity and factor, expressing all prices in a common currency and adjusting for the real costs of moving goods or factors between locations". In essence, a single market requires not only the elimination of border measures and full national treatment of beyond-the-border measures applying to imports, but also harmonization of rules and procedures across participating states.

Clearly, the economic divide between ASEAN's older and newer members poses a problem in this regard and so paragraph 4 states that:

> The ASEAN Economic Community shall ensure that deepening and broadening integration of ASEAN shall be accompanied by technical and development cooperation in order to address the development divide and accelerate the economic integration of Cambodia, Lao PDR, Myanmar and Viet Nam through IAI and RIA so that the benefits of ASEAN integration are shared and enable all ASEAN Member Countries to move forward in a unified manner.

In the eyes of ASEAN's Members, intra-ASEAN cooperation is key in this regard, and so paragraph 5 states in turn that:

> The realization of a fully integrated economic community requires implementation of both liberalization and cooperation measures. There is a need to enhance cooperation and integration activities in other areas. These will involve, among others, human resources development and capacity building; recognition of educational qualifications; closer consultation on macroeconomic and financial policies; trade financing measures; enhanced infrastructure and communications connectivity; development of electronic transactions through e-ASEAN; integrating industries across the region to promote regional sourcing; and enhancing private sector involvement.

At the instigation of Thailand, Singapore and Malaysia, ASEAN's trade ministers, meeting in August 2006, are currently seeking to move the target date for achieving the AEC forward to 2015. This is expected to be confirmed during the ASEAN Summit at year-end in Cebu.[54]

(iii) Other Pillars

Finally, there are the other two pillars mentioned earlier in addition to the ASEAN Economic Community (AEC) - the initiatives for an ASEAN Security Community (ASC) and the ASEAN Socio-Cultural Community (ASCC). These are dealt with in Parts "A" and "C" of the Bali Framework respectively.

D. Towards a Single Market and Production Base: An ASEAN Economic Community

Ha Noi was about completing the AFTA but with the Bali II Declaration and Framework, ASEAN's ambition is now clearly fixed on the creation of an ASEAN Community. According to Bela Balassa's oft-quoted "stages approach", there are several varieties of economic integration, evincing both differences of kind and degree, be it in the form of a:[55]

> …free-trade area, a customs union, a common market, an economic union…[or]… complete economic integration. In a free-trade area, tariffs (and quantitative restrictions) between the participating countries are abolished, but each country retains its own tariff against nonmembers. Establishing a custom union involves,

> besides the suppression of discrimination in the field of commodity movements within the union, the equalization of tariffs in trade with nonmember countries. A higher form of economic integration is attained in a common market, where not only trade restrictions but also restrictions on factor movements are abolished. An economic union, as distinct from a common market, combines the suppression of restrictions on commodity and factor movements with some degree of harmonization of national economic policies, in order to remove discrimination that was due to disparities in these policies. Finally, total economic integration presupposes the unification of monetary, fiscal, social, and countercyclical policies and requires the setting-up of a supra-national authority whose decisions are binding for the member states.

So what is the ASEAN Economic Community? We should think things and not words, as Oliver Wendell Holmes once said, but one answer (albeit in "words" for ASEAN remains at that stage)[56] is that there should be a "single market" and a "single production base", with "free movement of goods, services and capital". As the then Prime Minister of Singapore put it, echoing paragraph 3 of the Bali II Framework (above):[57]

> [T]he need for ASEAN to press on with economic integration remains as urgent as ever, if not more so. We must push towards an ASEAN Economic Community: a single production base and a single market, with free movement of goods, services and capital. This is the only way to make sure we remain competitive in the face of growing regional and bilateral FTAs, post-Cancun.

In other words, what Balassa would probably call a "common market", but not a customs union and certainly not anything like the European Union. According to Ambassador Pierre Gramegna, for example, speaking at the United Nations University in 1997:[58]

> …ASEAN is a pure intergovernmental organization where decisions are taken by the ASEAN foreign ministers on the basis of consensus or unanimity. The EU …is more than an intergovernmental organization, which became clear when France practised the vacant chair policy in 1966. The Union has its own special legal status and extensive powers of its own. On the other hand the European Union is not a true federation to which national parliaments and governments are subordinate in important matters.

Speaking of the Council of Ministers, the Commission, the European Parliament and the European Court of Justice, he points out that nothing that is truly like these organs exist in ASEAN.

But this is not to say that ASEAN cannot have highly similar aspirations in some respects, indeed this is what prompts the comparison in the first place however inapposite it may be in some other fundamental ways. The argument has been made, for example, that ASEAN must strengthen its institutions, particularly (as we shall see below) in the context of its FTAs with major powers like China. As another observer has argued, ASEAN should rely on a rule-based and institution-oriented regime in these wider relations precisely because it may be dealing with a major power.[59] Moreover:[60]

> Institutional theory suggests that before the development of an institution, it is

> likely that all basic actors are rational and autonomous individuals interacting on the basis of rational choice. Governments are only acting in their self interest and thus will look out for their own gains. If however, like the EU, strong institutions are developed, particularly institutions that act as a supranational "honest broker" and one that acts as a supranational "impartial arbitrator", it is likely that would secure the interests of all members rather than favoring any particular member or a group of members.

While that may be to peer too far into the future, it at least identifies an important factor in moving the ASEAN project forward, and one which ASEAN leaders have a rational, self-interested reason to pursue.

3. Intimations of ASEAN's Wider Trade-Architectural Aspirations: The "MEGA JUMBO-JET" Metaphor

The discussion below considers ASEAN's drive to conclude FTAs with the three "ASEAN + 3" nations (China, Japan and Korea) as well as India. It will also consider FTAs and FTA negotiations between individual ASEAN nations and these countries as well as other countries in the wider Asian region and with countries outside the region. So far as ASEAN's FTA and FTA negotiations with China, Japan, Korea and India are concerned, we will discuss the aim purely of having a network of FTAs, at least at the initial stage, linking these partners with ASEAN as a whole purely on an "FTA model".

We will therefore put aside a range of overlapping and competing visions - for example, the East Asian Summit ("EAS"),[61] the deeper "East Asian Comprehensive Economic Partnership" proposal by Japan in 2006,[62] a Free Trade Area of the Asia-Pacific which would avoid the "Asia-bloc" outcome of the previous two proposals, and to embed such forms of regionalism within a wide Asia-Pacific geographical area,[63] and finally, the Indian-proposal of having "Pan-Asia Free Trade Area", possibly including Australia and New Zealand within it.[64] The reason we put these visions aside is hardly because of their lack of importance – indeed each has the potential to transform ASEAN's future, and to transform ASEAN's vision of the future. However, they have not advanced as far in actual practice as the network of FTAs which ASEAN has entered into or is in the process of active negotiation with China, Japan, Korea and India.

A. A "Mega Jumbo-Jet"

The drive towards the AEC is but a first step, the occasional cautionary official statement notwithstanding. ASEAN, it appears, aims to move in widening circles, encompassing a pan-Asian vision of the benefits of having an open, liberal Asian trading system and the following statement probably captures ASEAN's policy aspirations at the present time:[65]

> Strategically positioned between China and India is Southeast Asia. We are a significant market of half a billion people - equivalent to the whole of Europe… ASEAN is also jointly and individually negotiating Free Trade Agreements with

> China, India, Japan and Korea. So the economies of Asia are being integrated too. By 2025, it will be a different Asia, more integrated and less divided.

Singapore as a small, open trading nation has perhaps been a vocal advocate of ASEAN trade liberalization and of the region's economic integration. So it might be appropriate to start with a somewhat Singaporean visual mental imagery:[66]

> I like to think of new Asia as a mega jumbo jet that is being constructed. Northeast Asia, comprising China, Japan and Korea, forms one wing with a powerful engine. India, the second wing, will also have a powerful engine. The Southeast Asian countries form the fuselage. Even if we lack a powerful engine for growth among the 10 countries, we will be lifted by the two wings.

What does the mega-jumbo jet metaphor involve?

B. ASEAN's "Open Regionalism"

We have already mentioned ASEAN's "open regionalist" policy. Nothing prevents ASEAN members from extending the same preferences extended to ASEAN Members to non-Members as well. At least one study has shown, for example, that two-thirds of the goods coverage of the six original ASEAN members under the CEPT has also been liberalized multilaterally under the GATT following intra-ASEAN liberalization. This minimizes the risk therefore of trade diversion by substantially minimizing the difference between intra- and extra-ASEAN tariff rates.[67] One inference we might draw is that open regionalism has thereby allowed AFTA to serve as a kind of building block for global trade liberalization, and not as a stumbling block. This is supported indirectly by a study by the International Monetary Fund (IMF) finding no evidence of FTAs causing trade diversion in Asia. That study explains Asia, and especially ASEAN's, higher "openness" towards non-Members as having been due in part to two decades of unilateral concessions during the 1980s and 1990s.[68] We might also speculate further that there is no reason *at least in principle* that an East Asian Economic Community could not eventually result in wider liberalization outside of it under an open regionalist policy.[69]

But this clearly is not a foregone conclusion, and the proposition itself needs to be assessed more carefully in light of what we do know. We know that ASEAN wants to build an economic community because it represents a market the size of Europe and so as to allow ASEAN to open up (not close) trade with China, and also with India and Japan. The ASEAN Economic Community or AEC is therefore meant to allow ASEAN members to negotiate liberalization more effectively, and to seek bigger and better cuts for the trade in ASEAN goods and in ASEAN services particularly in light of China's rise.

The eventual creation of a "single ASEAN economic space",[70] however it might be described according to Balassa's typology, does not preclude the fruits of liberalization being spread more broadly. We might quibble about whether the GATT-born method of trade negotiations through reciprocal concessions best serves the ideal of liberalization, or whether it is not only second-best.[71] But whatever imponderables there are to this question, the test for the mega-jumbo jet lies, today at least, in the conceptual policy device of an open-regionalist policy. This is the common thread that should run through the ideas of the ASEAN Economic Community as well

as ASEAN's vision for Asian trade liberalisation and perhaps even, one day, some manner of integration. What does ASEAN's open regionalism really mean?

C. ASEAN + 3 & India

(i) China and Japan

As early as the ASEAN Economic Ministers' (AEM) meeting in Chiengmai in October 2000, the ASEAN secretariat had proposed studying the possibility of economic integration amongst the ASEAN + 3 (Japan, China and Korea). Following the absence of a consensus amongst ASEAN members, however, the Chair proposed a study of the feasibility of FTAs amongst the ASEAN + 3 members. This was accepted at the AEM and the ASEAN secretariat then put the proposal during ASEAN's meeting with the Ministers of Japan, China and Korea in Chiengmai. In the following month, Chinese Premier Zhu Rongji proposed an ASEAN-China FTA joint study at the ASEAN-China Leaders' meeting in Singapore.

Subsequently, the AEM-MITI meeting in Ha Noi in September 2001 established an Expert Group (EG) to commence a Closer Partnership Agreement (CEP) with Japan. The EG met several times prior to the AEM-METI meeting in Bandar Seri Begawan in September 2002 at which the AEM and METI recommended the commencement of negotiations on a framework agreement. That recommendation was accepted during the ASEAN-Japan Leaders' meeting in Cambodia in November 2002. As Hatakeyama Noboru puts it:[72]

> [T]he stimulus caused by the Japan-Singapore Economic Partnership Agreement (JSEPA) [concluded in …] towards FTAs in the Asian region has led to the reaction on the part of China, which has invited another action by Japan…[and Hegel would have called this]…a dialectical development.

At present, the ASEAN-China (/China-ASEAN) Framework Agreement is already in force and it is anticipated that the ASEAN-China FTA will have been concluded by 2010 with the ASEAN 6 (i.e. the original six Members of ASEAN), and by 2015 with all the ASEAN countries. On 1 July, 2005 the ASEAN-China Trade in Goods Agreement came into force,[73] overlapping with a separate track under the Early Harvest Programme for the liberalization of trade in goods which will be discussed further below. The Early Harvest Programme was implemented in January 2004.[74] The ASEAN-Japan negotiations were only launched in 2005 with a target date for an eventual ASEAN-Japan Closer Economic Partnership Agreement by 2012.[75]

(ii) Korea

Korea, because of concerns with agriculture, has been slower than China and India in its response, but has now caught up. Noboru observed dryly in 2003 that:[76]

> [I]t was President Kim Dae-Jung who proposed establishing an East Asian Vision Group (EAVG) at the second ASEAN plus three Summit Meeting held in Hanoi in December 1998. The EAVG came up with a recommendation at the fifth ASEAN plus three Summit Meeting…to establish an East Asia Free Trade Area (EFTA) that would mainly consist of the ASEAN plus three. So it is a bit ironic for Korea not to be ready for an FTA even if it is only between Korea and the ASEAN countries.

Indeed Korea had earlier, in 2002, concluded an FTA with Chile, but that is best seen as a cautious first-step. Following Korean President Kim's visit to Japan in 1998, there has since been some movement, at least at the level of officials, towards a Korea-Japan FTA.[77] Thus Korea should, in fairness, be judged according to its cautious stance overall.

In the case of the ASEAN-Korea FTA (AKFTA), the leaders at the ASEAN Economic Ministers+Republic of Korea (AEM-ROK) Summit in November 2004 have since:[78]

> …agreed that (i) negotiations for the AKFTA commence in 2005 and be concluded within 2 years, (ii) that ASEAN-6 and Korea eliminate tariffs for 80% of all products by 2009, as a key milestone in the realisation of the AKFTA.

An executive summary of the ASEAN-Korea Experts' Group (formed following the ASEAN-ROK Summit in Bali in 2003) report was used to guide the negotiations.[79] In December 2005, ASEAN leaders signed a Framework Agreement with Korea.[80]

(iii) India

During the Cold War, ASEAN turned towards the importance of China, especially in the position China not India. In 1971, India had signed a Treaty of Friendship and Cooperation with the Soviet Union. For all ASEAN's talk of non-alignment, the coalescence of ASEAN through its opposition to the Soviet-sponsored Vietnamese invasion of Cambodia was the glue which held ASEAN as an organisation together. In this, ASEAN preoccupied itself with China from the Sino-Soviet conflict to the US-China rapprochement. Subsequently, US-China-USSR relations continued to be a major preoccupation throughout the 1970s, as was US-China-Japan relations in the 1980s. But today India is on the rise and ASEAN turned towards India.[81]

This reorientation includes ASEAN's current FTA negotiations with India, in addition to ASEAN's policy of concluding FTAs with its ASEAN + 3 partners, namely China, Japan and Korea. To this end, the Framework Agreement to Enhance ASEAN-India Trade and Economic Cooperation was signed on 8 October 2003, and the target date for an ASEAN-India FTA (AIFTA) with the ASEAN 6 is currently 2011. The target date for an Indian FTA with all the ASEAN Members is 2016.[82]

(iv) The "Multi-Track" Approach

None of these efforts preclude a multi-track approach. What follows is a glimpse of the current state of FTA negotiations involving ASEAN nations pursuing a multi-track approach. While it may be hard to discern the exact trade policy (and strategic) thinking of individual nations, the attraction of a multi-track approach may be likened perhaps to having a gearbox and a gear-shift mechanism in pursuing a comprehensive trade policy. For example, if country A, acting collectively with countries B and C is pursuing an FTA with country D and the negotiations stall, policy-makers in country A would have the fall-back option of pursuing a bilateral directly with country D itself. In the long run, this may be seen to promote and not impede the formation of wider agreements as a temporary, partial answer to the so-called "convoy problem" – i.e. that trade liberalization moves at the speed of the "slowest" trading nation.[83] A multi-track approach could allow for greater flexibility in achieving trade liberalisation.

(a) Bilaterals with the ASEAN + 3 Nations & India

Individual ASEAN countries have been pursuing FTAs with China, India, Japan and Korea. A classic example is Singapore which has concluded FTAs with all the above but for China in relation to which negotiations have only recently been resumed, following earlier controversy over a visit by (then) Deputy Prime Minister Lee Hsien Loong to Taipei. Malaysia and the Philippines both concluded FTAs with Japan in 2005 and 2006,[84] respectively while Thailand-Japan negotiations are still ongoing. Thailand had earlier concluded the China-Thailand Accelerated Tariff Elimination Agreement.

Such accelerated tariff agreements are the result of an amendment to the ASEAN-China Framework Agreement on Comprehensive Economic Cooperation (hereafter, "China-ASEAN Framework Agreement"). Under its Early Harvest Programme (EHP), tariff concessions by the parties are intended to have been immediately realised. However, controversy arose over the possibility of free-riding where country A's concessions are immediately realized by all other Framework Agreement Members under the MFN clause without sufficient concessions in exchange. In a sense, this was a negotiating wrinkle since a pre-condition was the similar inclusion of the same products in the EHP schemes of MFN-treatment beneficiaries. However, the Philippines and China had failed to establish an EHP scheme, while others feared competition from efficient Thai farming. Malaysia broke away and proposed an innovative clause that would allow it to negotiate bilaterally with China in return for Chinese concessions under the EHP. [85] Thus, the tariff acceleration agreement was born.[86]

(b) Other Sub-Regional & Cross-Sub-Regional FTA Negotiations Involving ASEAN Nations

Aside from these bilaterals, there are also other sub-regional and cross-sub-regional initiatives involving ASEAN nations such as Thailand with India, amongst others, in relation to the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Co-Operation (BIMSTEC) FTA. Myanmar too is a party to the BIMSTEC FTA, and which includes India. The other parties to the BIMSTEC FTA aside from Thailand, Myanmar and India are Bangladesh, Bhutan, Nepal and Sri Lanka thereby covering a swathe of nations bordering the Bay of Bengal. The scheduled date for BIMSTEC's entry into force was July 2006.[87]

Finally, Malaysia recently concluded its Agreement on the Early Harvest Programme (EHP) for the Malaysia-Pakistan FTA,[88] while Singapore-Pakistan negotiations are on-going.[89]

(c) Bilaterals and Plurilaterals involving ASEAN Nations and Trading Partners outside Asia

And outside Asia altogether, Singapore has concluded its FTA with the United States as well as with the European Free Trade Area (EFTA), Jordan, Panama, Australia, New Zealand and with Chile in the context of the Trans-Pacific Strategic Economic Partnership (SEP) Agreement. And there are on-going negotiations with Bahrain, Canada, Egypt, Mexico, Pakistan, Peru, Sri Lanka, Kuwait, Qatar and the United Arab Emirates progressing at different speeds.[90]

Likewise, Malaysia is currently negotiating with Australia, New Zealand and the United States.[91] Thailand has concluded its FTA with Australia,[92] while US-Thailand FTA negotiations are on-going.[93] The Philippines, in addition to its FTA with Japan is negotiating with the United States. Brunei as we have already seen is a party to the Trans-Pacific SEP (which includes, in addition to Singapore, both Chile and New Zealand).

(d) The Slip-Stream of the Jumbo-Jet

So if we hear talk of a mega-jumbo-jet being constructed today spanning the breadth of South-to-East Asia, with Southeast Asia in between, we also see individual Southeast Asian nations pursuing the slipstream of that jet, but going beyond South Asia and East Asia. What does all this mean for the architecture of international trade (and investment)?

4. ASEAN & Trade Law Doctrine

There are three features in the legal architecture of ASEAN's latest trade liberalization treaties which should be noticed.

First, as we have seen, ASEAN member nations have adopted a multi-track approach. Some ASEAN countries are negotiating FTAs or have entered into FTAs with countries which ASEAN as a whole is also negotiating or has entered into FTAs or Framework Agreements with. Individual ASEAN countries have also negotiated or entered into FTAs with countries outside the ASEAN sub-region (i.e. cross-sub-regional FTAs), or even outside Asia (i.e. cross-regional FTAs), or some combination of these. The absence of an MFN provision - whether we are talking about an MFN clause limited in scope only to more favourable treatment given to others outside the FTA, or one that is more expansive and includes more favourable treatment given to those within the FTA membership - does what GATT Article XXIV essentially does. It removes the discipline of MFN treatment and allows for preferential treatment of one sort or another instead.

Secondly, ASEAN has entered into FTAs with non-WTO Members - currently, Cambodia and Laos with the recent accession of Viet Nam into the WTO.[94] The question in such a case is whether WTO disciplines in relation to the formation of FTAs also apply to FTAs between WTO and non-WTO members.

Thirdly, an ASEAN-wide FTA may utilize a "framework approach" instead, or at least at the outset. Here, the substance of the deal may not involve any multilateralised concessions at all. This is what happened in the case of the China-ASEAN FTA where, under the Early Harvest Programme, separate tariff reduction or elimination deals are concluded bilaterally. We may compare this sort of innovation in treaty-making with the case where there exist multilateralised concessions but no MFN requirement. In the latter case, so long as tariffs are kept within bound rates, better treatment given to, say, another non-FTA member under the first FTA through a further bilateral deal (i.e. a second FTA) will not require similarly favourable treatment being granted to members of the first FTA. Another example would be where an FTA member (where there are more than two) enters into a further deal with a second member without conferring similar benefits to a third FTA member – this is the case with China-ASEAN and with tariff acceleration under NAFTA. But neither of these cases is tantamount to a third, more extreme example which we will discuss below – namely, the case where there are no multilateralised concessions to start with, even if this might just be a half-way house on the way towards fully multilateralised concessions between all the FTA members.

We have already dealt with the features of a multi-track approach above. The discussion that follows deals with the second and third features identified above.

A. The "Non-WTO Member" Problem

(i) The "Textualist" View: "Any Other Country" in Article I & "As Between the Territories of Members" in Article XXIV:5

There are at least two approaches to whether an FTA concluded by a WTO Member with a non-WTO Member is permissible under Article XXIV of the GATT. According to the first, the GATT-WTO provides an answer somewhere in the text of the agreement, or in the proper interpretation of the text of the agreement - what I call here the "textualist" view.

According to this view, GATT Article I states that MFN treatment applies to treatment accorded by "any contracting party" to "any other country". Thus, at first glance, the "any other country" formulation would not be limited only to WTO-GATT contracting parties. But this begs the question. What, exactly, is the relationship between Article XXIV of the GATT-WTO and Article I?

Putting aside the special procedure under Article XXIV:10, does anything in Article XXIV extend the exception from the MFN obligation in Article I to FTAs between WTO contracting parties and non-parties? If not, the special procedure would have to be relied upon to justify an FTA with a non-WTO member country which seeks exemption from the MFN obligation in Article I of the GATT-WTO.[95]

So far as the proper interpretation of treaties goes, we might also turn to the practice of the GATT 1947 contracting parties. Such practice has been equivocal, both in terms of the individual instances in which the question arose, and over that extended period of time. The various incidents during which the question arose in the history of the GATT have been amply treated by Professor Won-Mog Choi in an unpublished manuscript.[96] The GATT Working Party

review of the Latin-American Free Trade Area (LAFTA) in 1960 states that "[d]oubts were expressed…[as to conformity with paragraphs 5 to 9 of Article XXIV of GATT]…in view of the fact that some member States were not contracting parties to the General Agreement". [97] How much doubt by how many members, and how many members would be required to establish such doubt dispositively? Similarly, in reviewing the European Free Trade Area (EFTA) when it was first formed (i.e. the Stockholm Convention), "certain members of the Working Party…had, so far, the greatest difficulty" in accepting that anything but the special procedure under Article XXIV:10 could justify MFN-exemption in the case of an FTA with a non-contracting party.[98] Finally, in relation to the Working Party's review of the UK-Ireland RTA, Ireland was encouraged to accede to the GATT.[99]

In a recent article, Professor Choi concludes that the question is ultimately to be governed by the language of Article XXIV: 5.[100] Paragraph 5 states that an FTA shall not be prevented from coming into being "as between the territories of contracting parties". But, as Choi points out,[101] this was due to a deliberate amendment to earlier proposed language during the drafting of the ITO Charter. Originally, the language proposed in the ITO draft Charter of 1947 would have permitted an exception to the ITO Charter MFN obligation in the case of FTAs between ITO parties and non-parties.[102] However, Article 44 of the ITO Charter in its final form confined this exception instead to the formation of customs unions or free-trade areas "as between the territories of Members" of the ITO.[103] In Choi's view, the amendment to the originally proposed language was, in all probability, made in response to France's request during the Havana Conference to form a customs union with Italy, which was not then a GATT Member.[104] Article 44 was adopted into the GATT by way of special protocol in June 1948,[105] becoming what is now Article XXIV:5 of the GATT-WTO. France agreed on condition that it would receive a waiver in respect of the Franco-Italy Customs Union.

Thus seen, GATT practice, indeed the intent of the Framers of Article XXIV:5 was, or so it may be argued, that FTAs between GATT/WTO Members and non-GATT/non-WTO Members should not enjoy the exception provided for under Article XXIV (i.e. Article XXIV:5 which says the formation of FTAs shall not be prevented) to the MFN obligation in GATT-WTO Article 1.

(ii) <u>Subsequent Practice under Article XXIV:10</u>

However, as Choi admits, subsequent practice beginning in the 1960s in relation to Article XXIV:10 which allows for a two-thirds majority of Members to approve an FTA between a Member and a non-Member, contradicts this understanding. Following the establishment of EFTA and LAFTA, opposition had grown to Article XXIV:10 when FTAs with non-GATT Members became more common. Choi surmises that the States which found this new opposition were especially the "powerful States in Europe and North America" which "exercised their influence" so that the normal review procedure under Article XXIV:7 was applied instead of the special approval/exemption procedure under Article XXIV:10. Today, the issue seems to have gone away with a pragmatic stance having been adopted by GATT (/WTO) Members since. Choi cites the example of the Japanese delegation's sentiments during the Committee on Regional Trade Agreements' (CRTA's) review of the Interim Agreements of the FTAs between the European Communities and Latvia, Lithuania and Estonia: [106]

> The representative of Japan said that, despite the fact that Latvia, Estonia, and

> Lithuania were not members of the WTO, his delegation expected them to respect the obligations of GATT Article XXIV and GATS Article V.

If we are allowed to speculate a little, it might be supposed that a systematic study of CRTA practice in reviewing FTAs will reveal that the standard CRTA "no progress" report, as is to be found in today's CRTA reviews of FTAs may be also in part a hangover of this historically-rooted pragmatism on the part of GATT/WTO Members. Nonetheless, ASEAN's recent practice, with Laos and until only recently, Viet Nam remaining ASEAN non-WTO Members, highlights the continued resonance of this problem under the rules of the GATT-WTO. It is one trade regime-design issue which Southeast Asia's FTA practice has thrown up for renewed consideration as we peer into the future(s) of global trade law and policy design.

Creating an MFN exception for WTO Members in their FTAs with non-Members who, by definition, are not obligated to multilateralise their concessions is *arguably* anathema to what the WTO stands for, as well as to the spirit of GATT Article XXIV which is to promote trade liberalization and not create further exceptions to it. But in a sense, as the recent example of Viet Nam shows, this problem disappears soon enough as non-WTO members eventually become WTO members.

B. "The China-ASEAN Tariff Acceleration Precedent"

This brings us to a more serious problem than the one discussed above. Recall that under the China-ASEAN Framework Agreement,[107] a tariff acceleration agreement allows a China-ASEAN Framework Member to avoid multilateralising its concessions under the Framework Agreement's (i.e. the FTA's) Early Harvest Programme. Putting aside the Enabling Clause (which China and ASEAN members can all rely on) or the Article XXIV:10 special procedure, this raises the question of whether the Framework Agreement's design would otherwise be WTO-compatible under the usual GATT-WTO Article XXIV approval procedure (i.e. under Article XXIV:7).

Under the normal procedure, the Framework Agreement would have to fulfill the "substantially all trade" requirement for intra-FTA trade under GATT Article XXIV:8, even if it fulfills GATT Article XXIV:5's requirement that "duties and other regulations of commerce" applying to the non-FTA members should be "not on the whole higher or more restrictive".[108] Could it be argued instead that a tariff acceleration agreement should be considered separately, or even under the different (and more relaxed) disciplines imposed for an "interim agreement" within the meaning of GATT Article XXIV:5?

Interestingly, the "substantially all trade" requirement under Article XXIV:8 does not apply in the case of an "interim" agreement, and it applies only to a final, full-blown FTA. Instead, the principal discipline applying in respect of an interim agreement is a surveillance mechanism under Article XXIV:5(c) – whereby a "plan or schedule for the formation of…[the FTA]…within a reasonable period of time" should be given.[109] Nonetheless, if other WTO Members consider that an FTA that fulfills both the "substantially all trade" and "not higher or more restrictive" requirements would not result within such a reasonable period, they could make such recommendations as they see fit.[110]

Be that so, allowing for such tariff acceleration agreements restricts the fruits of tariff liberalization within a regional trade agreement. It reduces or eliminates altogether the MFN device's scope for application under a geographically expansive trade liberalisation regime. One might say this is no different from resort to tariff acceleration elsewhere, such as under NAFTA's Article 302. According to Article 302, for example, tariff acceleration may be trilateral (i.e. between all three parties) or bilateral, in which case it would raise substantially similar questions.[111] The China-ASEAN tariff acceleration clause is therefore a mimic of NAFTA's Article 302 in this sense. But there is a conceptual and practical difference, and this is what makes the China-ASEAN tariff accelerator clause a precedent. In NAFTA, except for agriculture, there were substantive multilateralised concessions between all three NAFTA parties even if *subsequent* tariff acceleration might still take place bilaterally. In the case of China-ASEAN, however, the tariff acceleration idea goes towards the basic design of the FTA itself.[112] China found itself with 10 countries knocking separately on its door. As the tariff acceleration notion was conceived, there was to be little in terms of a "deal with ASEAN" as such – the "ASEAN" dimension being but an empty box to be filled later by separate, bilateral deals. These individual deals have little or no interconnection – namely, the grant of MFN status by ASEAN members to each other.

5. Conclusions

I have outlined an area for the creation of FTAs outside the scope of Article XXIV. Put simply, WTO regulation of FTAs only go so far, it seems unless we adopt the view that the WTO also regulates FTAs between WTO Members and non-Members.

It makes sense to think that the WTO not only might or does regulate such situations, but that it should. There is no evidence, or at least none yet, that ASEAN is less committed to the WTO than it was before. More trade liberalisation in Southeast Asia and in Asia generally would only fulfill the aims of the WTO, particularly as it is envisaged under Article XXIV:4 of the GATT-WTO. which states that: "The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements". That is the spirit of WTO permissiveness in relation to the formation of FTAs.

It is not unreasonable, or unexpected therefore that the WTO may have sound legal and policy reasons to regulate FTAs between its Members and others to ensure the achievement of the general aspiration of greater global trade liberalisation. Putting aside whether as a matter of legal doctrine Article XXIV:5 should therefore be read in the use of the words "between the territories of contracting parties" to preclude FTAs with non-Members (i.e. by applying the MFN obligation in Article I), it might be thought that it should be read in such a way as a matter of WTO policy.

However, our study of Southeast Asia's treaty behaviour raises another question. If WTO Members wish to enjoy the MFN-exemption under GATT Article XXIV in the case of FTAs with broad geographical coverage, can they also say that individual FTAs once constituted should become an MFN "no man's land" under the GATT-WTO? And indeed under the FTA too because the FTA contains no MFN obligation of any sort? Is this the darker side of "open

regionalism"? The problem of trade diversion is clearly much more than a symptom of the spaghetti bowl effect of complex, multiple rules of origin (ROOs).[113] It is also a legal design or architectural problem. That is why GATT Article XXIV imposes the disciplines it does on FTAs and customs unions – to ensure that, eventually at least, such FTAs lead to multilateralised or non-discriminatory concessions.[114] So what does it mean, for example, for an indeterminate number of countries being smaller than the number of WTO Members and the total number of trading nations to disapply the unconditional MFN doctrine altogether in their treaty design? Would our answer be determined at least in part by how large a number of nations that involves?[115] What if it were the total number of WTO Members minus one? ASEAN's recent practice and broader aspirations especially in the precedent set by the China-ASEAN Framework Agreement, prompts us at least to ask these questions.

Much of course depends on whether we view a broad disapplication of the MFN doctrine, in Southeast Asia or elsewhere, be it in the guise of an interim agreement or something else altogether, to be anathema to trade liberalization as a matter of sound policy and principle.[116] But some might consider the Earl of Grenville's advice to the British Minister in Washington in a dispatch of 12 February 1885 as good advice still more than a century later in respect of the future of global trade design as a whole:[117]

> The value of the clause in its usual form consists precisely in its absolute character…most-favoured nation clauses would cease to have any utility if it were open to one of the contracting parties, by subsequently attaching conditions to the grant of particular favours to third parties, to refuse such favours to the other contracting party on the ground that the clause did not operate in cases where such conditions had been attached.

Viewed as such, ASEAN's policy of open regionalism, a policy which *could* counteract trade diversion, also creates a trade regime-design challenge. ASEAN today has a choice as to whether it will just seek out other "mutually beneficial regional agreements" with key trading partners, or whether it will eventually seek to multilateralise its FTA gains more broadly.[118] For individual Southeast Asian nations, will they continue to seek out individual FTAs? This is the principal difference between Southeast Asia's trade regime design and, say, that of the European Union.[119]

Furthermore, Southeast Asia's experiment with China could establish a wider precedent. Even if it were seen, in all fairness, as only an interim measure which is itself intended to accelerate tariff reductions in the face of practical negotiating complexities, resort to the China-ASEAN tariff acceleration model does at least suggest that trade liberalization in Asia or indeed elsewhere could yet take place according this kind of "three-layered wedding cake" model. The WTO and its regime of multilateralised concessions are perched above, region-wide FTAs lie in the middle while bilateral FTAs form a further, bottom layer. In principle, there could be an infinite number of layers, but as with wedding cakes the bottom becomes the "largest" layer – i.e. there could be a shift towards more-and-more bilateral FTAs.[120] As for the "highest" layer - the WTO and multilateralised concessions – only that is real even as it comprises the smallest of the different layers. What then becomes the true value of the middle layer? In what way does it provide support for the top layer – i.e. in what way do region-wide FTAs further the objectives of the WTO, when compared to bilateral FTAs?[121]

From the WTO viewpoint at least it might be asked how all this, if it transpires more fully,

should shape our future thinking on the disciplines which the WTO currently imposes on FTAs.[122] One way of addressing the economic policy issue could be by way of specifying more closely what "open regionalism" should mean - i.e. a concept of open regionalism which is linked, be it directly or indirectly, to the eventual furtherance of multilateralised trade concessions.[123] Thinking through ASEAN's "non-WTO Member" and "tariff acceleration" features has served to illustrate the legal-doctrinal and trade design dimensions to this issue.

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[1] See the analysis of China's regional trade agreements policy in Jiangyu Wang, "China's Regional Trade Agreements: The Law, Geopolitics, and Impact on the Multilateral Trading System", (2004) 8 *Singapore Year Book of International Law* 119, generally. *Contra* Michael Ewing-Chow, "ASEAN-China FTA: Trade or Tribute?", (2006) 10 *Singapore Year Book of International Law* (forthcoming) (on file) (arguing that trade should not become historic overlordship, or "tribute" again). I am grateful to Professor Ewing-Chow for permission to use his unpublished research. All references to page numbers are to the manuscript only.

[2] George Yeo, "Foreword", in Tommy Koh & Chang Li Lin (eds.), *The United States-Singapore Free Trade Agreement: Highlights and Insights* (Singapore: IPS & World Scientific, 2004) at vii. See also Margaret Liang, "Singapore's Trade Policies: Priorities and Options", (2005) 22.1 *ASEAN Economic Bulletin* 49.

[3] See Michael Ewing-Chow, "The Asian Economic Community: ASEAN - A Building or a Stumbling Block for China and India Economic Cooperation", paper delivered at the Symposium on China, India and the International Economic Order, National University of Singapore, 23-24 June 2006 at 30 (on file with author). Again, I am grateful for access to unpublished research. All references to page numbers are to the manuscript only.

[4] See C.L. Lim, "Free Trade Agreements in Asia: Some Common Legal Problems" in Yasuhei Taniguchi, Alan Yanovich and Jan Bohanes (eds.), *The WTO in the Twenty-First Century: Dispute Settlement, Negotiations and Regionalism in Asia* (Cambridge University Press, 2007), 434-456.

[5] See Michael Ewing-Chow, "Southeast Asia and Free Trade Agreements: WTO Plus or Bust?", (2004) 8 *Singapore Yearbook of International Law* 193, at 193-198.

[6] Of course, viewing the spread of liberalization through multilateralised concessions as an overriding aim involves a distinct set of assumptions. For a seminal treatment of the MFN clause from the perspective of public choice theory, in particular the problem of protecting concessions made against future erosion *versus* the free-rider problem, see Warren F. Schwartz & Alan O. Sykes, "The Economics of the Most Favored Nation Clause", in Jagdeep S. Bhandari & Alan O. Sykes (eds.), *Economic Dimensions in International Law* (Cambridge: Cambridge University Press, 1997) 43 at 43-53, 58-65.

[7] ASEAN's earlier forms of economic cooperation consisted of (1) preferential trading arrangements which unlike today's FTAs employ a negotiated positive list of goods as opposed to a negative list subject to exclusions gradually to be phased out, and a discount on MFN tariffs, as opposed to a reduction and gradual elimination of tariffs, and (2) drawing a link between production and market through industrial allocation schemes (namely, the ASEAN Industrial Products or "AIP" Scheme formalized in 1980, the ASEAN Industrial Complementation Scheme or "AICS" Scheme formalized in 1981, and the ASEAN Industrial Joint-Venture Scheme or "AIJV" Scheme formalized in 1983) which were characterised by exclusive production rights and a discount on existing MFN tariffs (e.g. 50% in the case of the AIJV Scheme); see Rodolfo C. Severino, *Southeast Asia in Search of an ASEAN Community* (Singapore: Institute of Southeast Asian Studies, 2006) at 213-222.

[8] Lawan Thanadsillapakul, "ASEAN Regionalisation", paper presented at the WTO at 10 Conference, United Nations University, Tokyo, 25-27 October 2005 at 1. I am grateful to Professor Lawan Thanadsillapakul for access to her unpublished research. All references to page numbers are to the manuscript only. See further Denis Hew, "Introduction: Roadmap to an ASEAN Economic Community" in Denis Hew (ed.), *Roadmap to an ASEAN Economic Community* (Singapore: ISEAS Publications, 2005) at 4.

[9] For a discussion of earlier attempts by ASEAN to engage in economic cooperation in the form of ASEAN's early preferential trading agreements, see (*e.g.*) Jayant Menon, *Building Blocks or Stumbling Blocks: Regional Cooperation Arrangements in Southeast Asia*, ADB Institute Discussion Paper No. 41 at 6. The problems with these early PTAs,

according to Menon, was that unlike the CEPT in 1992, they were item-by-item, reflected insufficient tariff cuts in relation to too narrow a coverage of commodities, and that they also suffered from half-hearted implementation while neglecting to deal with non-tariff barriers (NTBs). Menon concludes that they were a failure.

[10] See Jesus Estanislao, "Southeast Asia: Development, Finance and Trade", in Simon S.C. Tay, Jesus Estanislao & Hadi Soesastro (eds.), *A New ASEAN in a New Millenium* (Jakarta: Centre for Strategic & International Studies/Singapore Institute of International Affairs: 2000) at 66, 67-68.

[11] See Simon S.C. Tay, "Institutions and Processes: Dilemmas and Possibilities", in Tay, Estanislao & Soesastro (eds.), *A New ASEAN in a New Millenium*, *op. cit.* at 155, 156.

[12] Speech by H.E. Ong Keng Yong, ASEAN Secretary-General, 22 March 2003, Ballroom of the Regent Hotel, Singapore (on file).

[13] Jusuf Wanandi, "Strategic Developments in East Asia and the Role of the East Asian Community", (2006) 8.1 *Panorama: Insights into Southeast Asian & European Affairs* 51 at 58.

[14] See the discussion of the "Bali Declaration", below.

[15] Nor does it mean that economic and security considerations are easily separated, see Acharya's analysis of the economic dimensions of the security equation in ASEAN-China relations; Amitav Acharya, *Seeking Security in the Dragon's Shadow: China and Southeast Asia in the Emerging Asian Order*, Working Paper, Institute of Defence and Strategic Studies, March 2003.

[16] For a succinct treatment of ASEAN's "holistic" approach (and ASEAN's need for such a broad approach), see Estanislao, "Southeast Asia: Development, Finance and Trade", *op. cit.* generally.

[17] See Simon S.C. Tay, "Institutions and Processes: Dilemmas and Possibilities", *op. cit.* at 155-157.

[18] But this is perhaps limited to activist viewpoints, stressing the lack of movement towards the institutionalisation of human rights in ASEAN or more robust environmental governance, for example, as a result of such a cumbersome decision-making structure. For an overview, see (*e.g.*) Paul J. Davidson, "The ASEAN Way and the Role of Law in ASEAN Economic Cooperation", (2004) 8 *Singapore Year Book of International Law* 165.

[19] For a critique, see (*e.g.*) Ross P. Buckley & Sarala M. Fitzgerald, "An Assessment of Malaysia's Response to the IMF during the Asian Economic Crisis" [2004] *Singapore Journal of Legal Studies* 96.

[20] Framework Agreement on Enhancing ASEAN Economic Cooperation, Singapore, 28 January 1992; Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area, 28 January 1992.

[21] See the website of the ASEAN secretariat at: <www.aseansec.org>.

[22] *Agenda for Greater Economic Integration*, Fifth ASEAN Summit, Bangkok, December 1994.

[23] See Mohamed Ariff, "Trade, Investment and Interdependence", in Tay, Estanislao & Soesastro (eds.), *A New ASEAN in a New Millenium*, *op. cit.* at 45, 47, but for a more detailed guide to the time-lines, see Lawan, "ASEAN Regionalisation", *op. cit*. at 3-4.

[24] See Severino, *op. cit.* at 226 for the negotiating history and the national policy reasons of these newer members. See also the website of the US-ASEAN Business Council at: <www.us-asean.org>.

[25] See the *Statement on Bold Measures*, 6th ASEAN Summit, 16 December 1998, Ha Noi, Viet Nam.

[26] *Ha Noi Plan of Action*, 6th ASEAN Summit, 15-16 December 1998, Ha Noi, Viet Nam.

[27] *Id*., para. 2.1.

[28] *Id*. para. 2.1.1.

[29] See "ASEAN Moves Ahead", *op. cit*.

[30] See further the Framework Agreement on the ASEAN Investment Area, Brunei Darussalam, 7 October 1998 (hereafter, "ASEAN Framework Agreement on Investment"), and the Agreement Among the Government of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore, and the Kingdom of Thailand for the Promotion and Protection of Investments ("ASEAN Investment Treaty"), Manila, 15 December, 1987, and the Protocol to Amend the Agreement Among the Government of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore, and the Kingdom of Thailand for the Promotion and Protection of Investments, 12 September 1996 ("1996 Protocol").

[31] Ha Noi Plan of Action, para. 2.2.a. For a discussion and critique of the Temporary Exclusion List and the Sensitive List devices, see Ewing-Chow, "The Asian Economic Community", *op. cit*. at 7: "While flexibility is required…as a result of these loopholes, there are effectively no real rules or obligations which ASEAN [M]embers are bound to in relation to ASEAN's internal tariff reduction. Indeed, the very genesis of the CEPT Protocol [establishing the Temporary Exclusion List scheme] was as a retrospective legitimization of Malaysia's withdrawal in 2002 of automobiles and completely knocked down automobile kits from the AFTA reductions it had previously agreed upon". Both devices allow for what Ewing-Chow has tersely dubbed "backtracking" on the part of ASEAN Members.

[32] *Id*., para. 2.2.

[33] ASEAN Framework Agreement on Investment, *op. cit*., Art. 7(1)(b).

[34] *Id*., Art. 2(a).

[35] *Id*., Art. 4(c)

[36] *Id*., Art. 7.

[37] *Id*., Arts. 8 & 9.

[38] ASEAN Investment Treaty, *op. cit*., Art. 2(1).

[39] *Id*., compare Arts. 4(2) & 4(4).

[40] *Id*., Arts. 4(1) & 4(2).

[41] *Id*., Art. 6(1).
[42] *Id*., Art. 10(2). See further M. Sornarajah, "Protection of Foreign Investment in the Asia-Pacific Economic Co-Operation Region", (1995) 29 *Journal of World Trade* 105 at 122-3.
[43] Ha Noi Plan of Action, *op. cit.*, para. 2.3.1.b.
[44] Declaration of ASEAN Concord II (Bali Concord II), 7 October 2002 (hereafter, "Bali Concord II Declaration").
[45] References to an ASEAN Economic Community had also been made slightly earlier, thus at the Thirty-Sixth ASEAN (Foreign) Ministers' meeting in Phnom Penh, the Ministers issued a joint communiqué "reaffirmed the need to move deeper economic integration toward an ASEAN economic community"; Joint Communique of the Thirty-Sixth ASEAN Ministerial Meeting, Phnom Penh, 16-17 June 2003 at para. 8.
[46] Bali Concord II Declaration, para. 1.
[47] *Id*., para.2.
[48] *Id*., para. 7.
[49] Bali Concord II Declaration, para. 9.
[50] "Bali Framework" of the Declaration of ASEAN Concord II, para. 1, Part B.
[51] *Id*., para. 2.
[52] *Id*., para. 3.
[53] Jiangyu Wang, "China, India and Regional Economic Integration in Asia: The Policy and Legal Dimensions", paper delivered at the Symposium on China, India and the International Economic Order, National University of Singapore, 23-24 June 2006 (on file with author, forthcoming in the *Singapore Year Book of International Law*); quoting from Peter J. Lloyd, "What is a Single Market? An Application to the Case of ASEAN", (2005) 22:3 *ASEAN Economic Bulletin* 251, at 252-254. I am grateful to Professor Wang for permission to use his unpublished research. All references to page numbers are to the manuscript only.
[54] En-Lai Yeoh, "Southeast Asia Speeds Single Market Plan", Associated Press, 22 August 2006 (on file).
[55] Bela Balassa, *The Theory of Economic Integration.* (Homewood, Illinois: Richard D. Irwin, 1961) at 1-2, quoted in Wang, "China, India and Regional Economic Integration", *op. cit*. at 2.
[56] Former ASEAN Secretary-General Rodolfo Severino put it this way: "AFTA has seen little actual use by traders. The other foundations for regional integration have not been built upon. Regional economic integration seems stuck in framework agreements, work programs and master plans"; Rodolfo C. Severino, "The Future of ASEAN Economic Integration", Address at the Joint Conference of INSEAD & the Asia-Europe Foundation, Singapore, 7 July 2003 at 3 (on file).
[57] This was what Singapore's then Prime Minister said, citing the concerns of business leaders that lowering tariffs was not enough, and that manufacturing operations should be "linked seamlessly throughout the region" thereby allowing MNCs to "leverage on the diverse cost structure and comparative advantage across ASEAN"; Keynote Address by Prime Minister Goh Chok Tong at the ASEAN Business and Investment Summit, 6 October 2003, Bali, Indonesia, available at the ASEAN Secretariat website: <www.aseansec.org>. This is therefore linked to the view that ASEAN should be made attractive to foreign direct investment.
[58] H.E. Mr. Pierre Gramegna, "EU and ASEAN Integration Processes: Similar Models?", U.N.U. Public Forum, 8 May 1997, Tokyo, Japan (on file).
[59] *Cf*. Ewing-Chow, "Trade or Tribute", *op. cit*. at 21.
[60] *Id*. at 20.
[61] Comprising ASEAN, China, Japan, Korea, India, Australia and New Zealand with the Russian Federation currently having observer status during the first summit in Kuala Lumpur in 2005. The decision to hold the First Summit in Kuala Lumpur was made during the 2004 ASEAN + 3 Summit. The current ASEAN Secretary-General, H.E. Mr. Ong Keng Yong has thus far described the EAS as a "forum for dialogue on broad strategic, political and economic issues"; H.E. Ong Keng Yong, "Leadership and Strategic Visions for the Development of East Asia", Second Asian Economic Forum, University of Cambodia, Phnom Penh, 25 April 2006.
[62] Also known as the "CEPEA" (or "Comprehensive Economic Partnership for East Asia"), the "Nikai Initiative" or the "East Asian OECD", this proposal was formally announced in April 2006 by the Japanese trade minister, Toshiro Nikai. This proposal would include an East Asian Free Trade Agreement between the current members of the East Asian Summit (ASEAN, China, Japan, Korea, India, Australia and New Zealand). See (e.g.) "Japanese Government to Propose Big Asian Free Trade Zone" (AFX News), available on the Forbes website at <www.forbes.com>.
[63] Fred Bergsten, "Plan B for World Trade: Go Regional", *Financial Times* [U.K.], 16 August 2006; *contra* Sungjoon Cho, "'Plan B' is Always Inferior to 'Plan A'", *Financial Times* [U.K.], 22 August 2006.
[64] C. Chitti Pantulu, "Manmohan Singh Sells his Vision of a Pan-Asian FTA", available on the Daily News & Analysis (Mumbai) website at <www.dnaindia.com>.
[65] "Global City of Opportunity", Keynote Address by Senior Minister Goh Chok Tong of the Republic of Singapore at the Singapore Conference, 15 March 2005 At 0930, Ballroom, the Millenium Mayfair, London, Singapore Government Press Release, 15 March 2005.
[66] *Id*.
[67] Menon, *Building Blocks*, *op. cit*. at 8. According to Jacob Viner, trade diversion is shown by a shift in production from a lower-cost producer outside the FTA to a higher-cost producer within and an FTA is efficiency and welfare reducing if it results in more trade diversion than trade creation; Nigel Grimwade, *International Trade Policy* (London: Routledge, 1996) at 237-238. Viner in his *Customs Union Issue* (Washington D.C.: Carnegie Endowment

for International Peace, 1950) is therefore credited with having exploded the myth that preferential trade agreements are therefore necessarily efficiency and welfare improving. See further Carnegie Endowment Study Group on International Trade, *Reflections on Regionalism* (Washington D.C.: Carnegie Endowment for International Peace, 1997) at 11-18.

[68] International Monetary Fund, *Asia and Pacific Regional Economic Outlook* (Washington D.C.: International Monetary Fund, Inc., 2006), available on the Fund's website at <www.imf.org>. See also Wang, "China, India and Regional Economic Integration in Asia", *op. cit*. at 7.

[69] There is a whole host of imponderables to this question. For example, whether and how such a grouping would, or could integrate with South Asia to form a wider grouping and how both this and a wider grouping would behave – would a fortress mentality result? See (*e.g.*) Carnegie Endowment Study Group on International Trade, *Reflections on Regionalism*, *op. cit.* at 11-18; *cf*. the "policy recommendations" in Wang, "China, India and Regional Economic Integration in Asia", *op. cit.* at 34-37.

[70] For the metaphor, see Association of Southeast Asian Nations, *Towards a Single Economic Space*, Public Information Series (Jakarta: ASEAN Secretariat, 2003).

[71] See (*e.g.*) Andreas F. Lowenfeld, *International Economic Law* (Oxford: Oxford University Press, 2002) at 45-67.

[72] Hatakeyama Noboru, "A Short History of Japan's Movement to FTAs (Part 3)", 22 *Journal of Japanese Trade & Industry*, March/April 2003 at 42.

[73] *Agreement on Trade in Goods (TIG) of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China*, 29 November 2004, available at the ASEAN Secretariat website: <www.asean.org>.

[74] See the Singapore Government FTA website: <www.app.fta.gov.sg>. See further, Raul L. Cordenillo, "The Economic Benefits to ASEAN of the ASEAN-China Free Trade Area (ACFTA)", Studies Unit, Bureau for Economic Integration, ASEAN Secretariat, 18 January 2005, available on the ASEAN Secretariat website at: <www.aseansec.org>.

[75] See the Singapore Government FTA website: <www.app.fta.gov.sg>.

[76] *Id*. at 43.

[77] See Won-Mog Choi, "Regional Economic Integration in East Asia: Prospect and Jurisprudence", (2003) 6 *Journal of International Economic Law* 49 at 53-54 (also stressing the agriculture issue for Korea).

[78] See the ASEAN-Korea FTA (AKFTA) section on the Singapore Government FTA website: <www.app.fta.gov.sg>.

[79] *Id*.

[80] Framework Agreement on Comprehensive Economic Cooperation Among the Governments of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea, Kuala Lumpur, 13 December 2005, website of the ASEAN Secretariat at: <www.aseansec.org>.

[81] See (*e.g.*) "Speech by Mr. Goh Chok Tong, Senior Minister at the Official Launch of the Institute of South Asian Studies, ISAS, 27 January 2005", Orchard Hotel, Singapore, *Singapore Government Press Release*, 27 January 2005.

[82] See the Singapore Government FTA website: <www.app.fta.gov.sg>. The ASEAN-India negotiations has of late been plagued by delays, see (*e.g.*) Ravi Velloor, "ASEAN-India FTA Faces Another Delay", *Straits Times* [Singapore], 8 November 2006.

[83] See Ewing-Chow, "Southeast Asia and Free Trade Agreements, *op. cit*. at 200.

[84] See the Japan Ministry of the Economy, Trade and Industry website: <www.meti.go.jp>.

[85] See (*e.g.*) Jiangyu Wang, "China's Regional Trade Agreements: The Law, Geopolitics, and Impact on the Multilateral Trading System", (2004) 8 *Singapore Year Book of International Law* 119 at 126.

[86] *The Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation Between the Association of South East Asian Nations and the People's Republic of China,* 6 October 2003, available at the ASEAN Secretariat website: <www.asean.org>, Article 2(i)(2), and Article 2 generally. Note that Article 2(i)(1) also provides for unilateral concessions; see *id*. Even more curious is Article 4. See *Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation Between the Association of South East Asian Nations and the People's Republic of China,* 6 October 2003, available at the ASEAN Secretariat website: <www.asean.org>, Article 4 which reads:

"The Framework Agreement shall be amended by inserting a new Article 12A immediately after the existing Article 12 of the Framework Agreement as follows:

> ARTICLE 12A: Agreements Outside this Agreement
> Nothing in this Agreement shall prevent or prohibit any individual ASEAN Member State from entering into any bilateral or plurilateral agreement with China and/or the rest of the ASEAN Member States relating to trade in goods, trade in services, investment, and/or other areas of economic co-operation outside the ambit of this Agreement. The provisions of this Agreement shall not apply to any such bilateral or plurilateral agreement."

What does "outside of the ambit of this Agreement" mean?

[87] See "BIMSTEC FTA to Come into Effect from July, 2006", available at the website of the Ceylon Chamber of Commerce: <www.chamber.lk>.

[88] See "Signing of Agreement on the Early Harvest Programme for the Free Trade Area between Malaysia and Pakistan", Malaysian Government Press Release, available at the Malaysian Ministry of Trade and Industry website: <www.miti.gov.my>.

[89] See the Singapore Government FTA website: <www.app.fta.gov.sg>.

[90] *Id*.
[91] See "Mahathir Fears Planned FTA with US Could Have "Adverse" Consequences", *The Star* [Malaysia], 22 March, 2005, also available at the bilaterals.org website: <www.bilaterals.org> .
[92] See the website of the Australian Department of Foreign Affairs and Trade: <www.dfat.gov.au>. See also Nataya Seetubtim, 'Thailand FTAs', June 2004, website of the ASEAN Secretariat at: <www.aseansec.org>.
[93] See the US-ASEAN Business Council website: <www.us-asean.org>. See also the announcement in 2003 of the launch of US-Thailand negotiations, "Fact Sheet on Free Trade and Thailand", White House Press Release, 20 October, 2003, available at the White House website: <www.whitehouse.gov>.
[94] See (*e.g.*) "Vietnam Gets WTO Entry", *Straits Times* [Singapore], 8 November 2006.
[95] Or if applicable, the so-called "Enabling Clause". But it appears that the Enabling Clause too would not permit an exception to the MFN obligation in the case of an FTA between a WTO Member and a non-Member. Paragraph 2(c) of the Enabling Clause permits "differential and more favourable treatment" in the case of "regional or global arrangements entered into amongst less-developed contracting parties", and thus contemplates only FTAs between GATT Members; "Decision on Differential and More Favorable Treatment and Reciprocity and Fuller Participation of Developing Countries" (GATT Contracting Parties Decision of 28 November 1979, L/4903), paragraph 2(c). In support of this reading, see also Won-Mog Choi, "Integrating Trade in Goods and Services with ASEAN including Non-WTO Members, and WTO Jurisprudence", paper delivered at the National Taiwan University, 8-9 July, 2005 (on file with author) at 18.
[96] Choi, "Integrating Trade in Goods and Services", *ibid.* I am grateful to Professor Won-Mog Choi for permission to draw on his unpublished research in the account given below (correspondence, 18 August 2005). All references to page numbers are to the manuscript only.
[97] Customs Unions and Free-Trade Areas: Latin American Free Trade Area, Report adopted by the GATT Contracting Parties, BISD Supp. 9 at para. 31.
[98] Customs Unions and Free Trade Areas: European Free Trade Association, Report adopted by GATT Contracting Parties (1960) BISD Supp. 9 at para. 58.
[99] United Kingdom/Ireland Free-Trade Area Agreement, Conclusions adopted on 5 April 1966, BISD 14S/23.
[100] Choi, "Regional Economic Integration", *op. cit*. at 74.
[101] Choi, "Integrating Trade in Goods and Services", *op. cit*. at 8.
[102] Article XXI of Draft GATT & Article 38 of Draft Charter of ITO, Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment, 20 January to 25 February 1947, New York at 78.
[103] Paragraph 2 of Article 44 of the Charter for an International Trade Organization ("Havana Charter"), *Report of Committees and Principle Sub-Committees of the United Nations Conference on Trade and Employment* ("Havana Report"), U.N. Doc. ICITO 1/8 (1948); *United Nations Conference on Trade and Employment, Final Act and Related Documents*, U.N. Doc. E/Conf.2/78 (1948).
[104] Choi, "Integrating Trade in Goods and Services", *op. cit*. at 9.
[105] Special Protocol relating to Article XXIV of the General Agreement on Tariffs and Trade, 24 March 1948, 62 UNTS 56.
[106] Examination of the Interim Agreements between the European Communities and the Czech Republic, Slovak Republic, Hungary, Poland, Bulgaria and Romania and the Free Trade Agreements between the European Communities and Estonia, Latvia and Lithuania, Note on the Meeting of 19 June 1997, WT/REG1/M/2; WT/REG2/M/2; WT/REG7/M/2; WT/REG8/M/2; WT/REG9/M/2; WT/REG18/M/2 (3 October 1997), para. 33.
[107] See section III.C(iv)(a), earlier above.
[108] As is well-known, neither "substantially all the trade" nor "other regulations of commerce" have been well-defined under the GATT. For example, it has been argued that rules of origin comprise "other regulations of commerce" and their complication (a feature of the "spaghetti bowl effect") would make them "more restrictive" for non-FTA members; see (*e.g.*) Mitsuo Matsushita, Thomas J. Schoenbaum & Petros C. Mavroidis, *The World Trade Organisation – Law, Practice & Policy* (Oxford: Oxford University Press, 2003) at 351-2. As for "substantially all trade", one principal difficulty has to do with whether it represents a qualitative or quantitative measure, or indeed both; see further *id*. at 359-360. However, the Appellate Body has considered in the *Turkey-Textiles Case* that "it is clear that 'substantially all the trade' is not the same as *all* the trade, and also…is something considerably more than merely *some* of the trade"; *Turkey - Textiles* (1999), WTO Doc. WT/DS34/AB/R at para. 48. That still leaves open the question of, for example, whether a quantitative approach ("putting a number to the concept") would suffice, and the problem of having to deal with such cases case-by-case, see Sungjoon Cho, "Breaking the Barrier Between Regionalism and Multilateralism: A New Perspective on Trade Regionalism", (2001) 42 *Harvard International Law Journal* 419 at 443. Again, the Appellate Body in *Turkey-Textiles* has suggested that both qualitative and quantitative aspects are suggested by the ordinary meaning of the terms - see *Turkey-Textiles*, *op. cit.* at para. 49 – but that does not clear up the issue entirely. For "putting a number to the concept", see Australia's proposal in WTO, Committee on Regional Trade Agreements, Communication from Australia, WT/REG/W/22/Add. 1, 24 April 1998.
[109] This raises not only the problem of what a "reasonable period of time" is under this clause, but also the problem in practice that timely, prior notification (albeit mainly under ArticleXXIV:7) has been a discipline which the Members have not in practice observed.
[110] Wang agrees with Jackson that this would require that the other Members agree on the set of recommendations to

be made, and that this requirement therefore operates as a presumption in favour of the validity of notified agreements; "China's Regional Trade Agreements", *op. cit*. at 137; citing John H. Jackson, *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (Cambridge: Cambridge University Press, 2000) at 104.

[111] North-American Free Trade Agreement, 17 December 1992, Article 302. Article 302 is essentially a "successor" clause to the (bilateral) tariff reduction accelerator clause in Article 401.5 of the Canada-United States Free Trade Agreement, 2 January 1988.

[112] In the case of NAFTA, this design feature may be seen most clearly instead in agriculture. Negotiations on Canada's refusal to proceed with comprehensive liberalization and the elimination of agricultural marketing boards continued into May 1992. But from Montreal onwards the ministers had decided on two separate bilateral agreements on agriculture and from Montreal onwards, the negotiations proceeded on three separate bilateral fronts – between Mexico and Canada, Canada and the United States, and the Mexico and the United States; Maxwell A. Cameron & Brian W. Tomlin, *The Making of NAFTA: How the Deal was Done* (Ithaca: Cornell University Press, 2000) at 147. See further Hermann von Bertrab, *Negotiating NAFTA: A Mexican Envoy's Account* (Westport: Praeger & the Centre for Strategic & International Studies, 1997) at 53.

[113] See Jagdish Bhagwati & Arvind Panagariya, "Bilateral Trade Treaties are a Sham?", *Financial Times* [U.K.], 14 July 2003; Jagdish Bhagwati, "Preferential Trade Agreements: The Wrong Road", (1996) 27 *Law & Policy in International Business* 865 at 867. Or what Asian Development Bank Vice-President, Liqun Jin has dubbed the potential "Asian noodle bowl effect"; see "Issues and Challenges in Designing Free Trade Agreements in Asia – Welcome Remarks by Liqun Jin", 20 March 2006, available at the Bank's website: <www.adb.org>.

[114] See (*e.g.*) Frederick M. Abbott, "GATT and the European Community: A Formula for Peaceful Coexistence", (1990) 12 *Michigan Journal of International Law* 1 at 3; John McMillan, "Does Regional Integration Foster Open Trade? Economic Theory and GATT's Article XXIV" in Kym Anderson & Richard Blackhurst (eds.), Regional Integration and the Global Trading System (NY: St. Martin's Press, 1993) at 292.

[115] The GATT Framers never truly expected preferential trading arrangements to be as widespread or popular as they have become, see Patrick F.J. Macrory, Arthur E. Appleton & Michael G. Plummer (*eds*.), *The World Trade Organization: Legal, Economic & Political Analysis* (NY: Springer, 2005), Vol. II, at 222.

[116] See (*e.g.*) Peter Sutherland, *The Future of the WTO: Addressing Institutional Challenges in the New Millennium* (Geneva: WTO, 2004) at para. 60.

[117] *British and Foreign State Papers*, Vol. 77 at 325.

[118] Although in all fairness, would this not just depend on whether ASEAN's aspirations will receive the verdict on the European Community? Namely, that: "In the event, the creation of the European Common Market in 1958 changed, but did not weaken the international law of international trade as embodied in the GATT. On the one hand, the Treaty of Rome…conformed to the requirements for customs unions prescribed in the GATT. On the other hand, the European Community came to the fore within the GATT, negotiating and acting as a unit and on substantially equal terms with the United States"; see Lowenfeld, *International Economic Law*, *op. cit*., at 47. And does this not itself involve an overstatement of the historical record? In a sense, it was disagreement over the compatibility of the European Economic Community with GATT Article XXIV which has caused the CRTA's FTA compliance surveillance task to have come to a virtual standstill; see Wang, "China's Regional Trade Agreements", *op. cit*. at 136. For the economic and political theory on whether FTA formations will lead to a fortress mentality and thereby become more resistant to trade liberalization over time instead, see Carnegie Endowment Study Group on International Trade, *Reflections on Regionalism*, *op. cit.* at 11-18.

[119] Even ASEAN countries have at times failed to note the difference. Malaysia, for example, reacted strongly to Singapore's FTA programme at the beginning, alleging that Singapore's FTAs would be a Trojan Horse into ASEAN for other non-ASEAN nations. See "A Vital Role for Singapore in ASEAN Trade Relations", *the New Straits Times* [of Malaysia], 1 May 2003. On the "bandwagon effect" in ASEAN following the Singapore FTAs, see Ewing-Chow, "Southeast Asia and Free Trade Agreements", *op. cit*. at 200. For the exclusive competence of the Community, at least in relation to the trade in goods, see the ruling of the European Court of Justice in Opinion 1/94, *Agreement Establishing the World Trade Organisation* [1994] E.C.R. I-5267.

[120] For an analysis of some of the causes, see Margaret Liang, "The Realpolitik of Multilateral Trade Negotiations from Uruguay to the Doha Round", (2004) 8 *Singapore Year Book of International Law* 149, generally.

[121] For the suggestion as to how a Free Trade Area for the Asia-Pacific could save the WTO multilateral process, see Fred Bergsten, "Plan B for World Trade: Go Regional", *op. cit*.; *contra* Sungjoon Cho, "'Plan B' is Always Inferior to 'Plan A'", *op. cit*. This paper has argued for a nascent "obligation to multilateralise".

[122] To the extent that FTAs are meant to be building blocks, should it cause a rethinking of the "desirability" of FTAs, particularly as to what is desired, and what is undesirable? Article XXIV:4 of the GATT-WTO states that: "The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements".

[123] See (*e.g.*) Fred C. Bergsten, *Open Regionalism*, Working Paper 97-3 (Washington D.C.: Institute for International Economics, 1997), available online at the Institute's website: <www.iie.com>. Bergsten's recommendations were directed at the Asia-Pacific Economic Cooperation (APEC) forum, but he argues that they should also apply to other FTAs; *id*. His recommendations draw on the work of the APEC Eminent Persons' Group (EPG) from 1993-1995; see *id*.

Chapter

3

THE NEW INTERNATIONAL ARCHITECTURE IN TRADE AND INVESTMENT

CURRENT STATUS AND IMPLICATIONS

Issue Papers

Some Legal Issues of FTAs under WTO

Written by

Mitsuo Matsushita

Professor Emeritus
The University of Tokyo

1. Customs Unions and Free Trade Areas as Factual Issues

About 90% of the Members of WTO are participants of FTAs (customs unions and free trade areas).[1] In 1999, there were 107 agreements reported to WTO under Article XXIV of the GATT 1994 and under the Enable Clause.

This fact presents a significant challenge to the WTO and the multilateral trading system under the WTO. Proliferation of bilateral and regional agreements may undermine the effectiveness of the multilateral trading system and may jeopardize the existence of WTO. However given the fact that there are so many of such agreements and such agreements include important trade entities as the EC (the European Communities), the NAFTA, MERCOSUR and some others, it is obvious that WTO has to co-exist with them. The core issue is how to recognize the existence of FTAs and yet to control them so that they would not undermine the WTO system. Legally this is primarily the matter of how to interpret provisions of Article XXIV of the GATT 1994.

One of the striking features of recent FTAs is that there are not only alliances between trading economies but also there are alliances between one FTA and another FTA which comprehend larger areas. Examples include: EEA (European Economic Area, which is an alliance between EU and Norway, Iceland and Lichtenstein) and FTAA (NAFTA and MERCOSUR) and SAFTA (an expanded MERCOSUR).

[1] The term "FTAs" refers to free trade agreements, and "RTAs" refers to regional trade agreements. The term "FTAs" is a larger concept than RTAs, since it includes RTAs as well as bilateral trade agreements entered into by two countries. In this paper, the term "FTAs" is used in the sense that it includes bilateral trade agreements, RTAs and customs unions.

2. Multilateralism and FTAs

FTA is a bilateral or regional arrangement and necessarily involves some discriminatory treatment *vis-à-vis* outside parties. This creates disparity in competitive conditions among trading economies. In this respect, FTA agreements have some distorting effects on the natural flow of international trade and investment in the multilateral trading order. On the other hand, negotiations on a multilateral level as expressed in WTO ministerial conference are becoming difficult as exemplified by the failures of WTO ministerial conferences in Seattle (1999) and Cancun (2003). In 2005, a WTO ministerial conference was held in Hong Kong, China. This conference was a moderate success in the sense that it did not break down. However, the only accomplishment of the Hong Kong Ministerial Conference was that Members agreed to continue negotiations and, as the subsequent talks at the WTO indicate, there is no sign of progress yet.

Given the above situation, one may argue that FTA liberalizes internal trade among the members and that this partial liberalization promotes more trade. Compared with negotiations at the WTO which have been stalemated, even partial liberalization through FTA would promote international trade. If there are many such FTA agreements, this may eventually lead a way to the liberalization of trade in the multilateral trading order.

This may be too optimistic a view. However, if the WTO is successful in reining operations of FTA agreements within some limits, FTA agreements may be the only practical way of liberalizing trade today.

3. Working Parties Reports

In the past, there were many instances in which working parties were established to examine compatibility of a FTA and GATT/WTO disciplines under Article XXIV of the GATT. However, in almost all of such working parties, there was a sharp difference of views regarding compatibility of a FTA with GATT/WTO rules and, in the reports of those working parties, usually there are two opposing views listed side by side. One advocates that a FTA is compatible with GATT/WTO rules and other criticizes the FTA as not compatible with GATT/WTO rules. The issue of how to interpret Article XXIV in relation to FTAs was raised first when EEC was established in 1957. Since that time until 1994, 69 working parties were established to examine compatibility of FTAs under GATT rules but in only six out of 69 working parties, a consensus was reached. The reason for this poor performance is conflicting interests among Members. Those which formed FTAs advocate their interests in maintaining them while those outside the FTA criticize it. In part, the difficulty is the vagueness of the text of Article XXIV such as “substantially all”, “other trade restrictions” and “on the whole”. Only a handful of panels were established to examine the legality of FTAs in light of Article XXIV and, in all of them, the panel reports remain unadopted.

In light of the above situation, one can say that legal issues of FTAs in relation to GATT/WTO are largely unresolved yet.

4. How to Facilitate the Formation of FTAs under WTO?

The core of legal issues relating to the relationship between FTAs and the WTO regime is to construct an interpretation of provisions of Article XXIV of the GATT 1994 which allows sufficient flexibility to form FTAs but leaves enough disciplines on the operations of FTAs. Often when a FTA is negotiated, there are sector-specific problems. Typical of such problems are those in agriculture and textile industry. If disciplines of WTO rules are too tight, this may prevent or delay the formation of a union or an agreement which may be useless not only to the members concerned but also to the world trading system.

(a) "Substantially All" Approach

Under some circumstances, it may be necessary to leave some sensitive sectors of the economy outside the scope of liberalization. This relates to interpretation of the requirement in Article XXIV which states that "substantially all" of commerce inside a FTA should be liberalized. If one takes the position that this language means only a quantitative level, then one can say that one or two sectors can be left out of the liberalization as long as internal trade restrictions are eliminated on the whole. However, if one takes the position that “substantially all” means not only a quantitative test but also a qualitative test, then it is not permissible to leave out an important sector from the liberalization.

For example, Korea and Japan have discussed a Korea-Japan FTA agreement. One of the issues here is agriculture. Imports of agricultural products from Korea to Japan occupy about 10 % of the total imports of Japan coming from Korea. If a quantitative test is adopted, one may argue that a Korea-Japan FTA agreement can leave out of its scope of liberalization this agricultural sector while leaving all other imports are liberalized. However, if one takes a qualitative approach, one would argue that an important sector such as agriculture cannot be totally set aside from the scope of the liberalization if the “substantially all” requirement should be complied with.

Considering the purposes and objectives of Article XXIV of the GATT, to leave out an important sector (such as agriculture) from the duty to liberalize seems to be contrary to the very purpose of Article XXIV. Although the wording “substantially all” can be interpreted to mean either a quantitative or a qualitative test, both quantitative and qualitative tests should be applied if one takes into account the purposes and objectives of Article XXIV of the GATT. After all, the GATT XXIV is aimed at allowing FTA while maximizing the benefit of trade liberalization and minimizing minus effects of bilateralism and regionalism.

With regard to the quantitative requirement, an issue is what is the percentage of trade that is liberalized if “substantially all” is to be satisfied. The EC has maintained that if 80% of the whole trade within a FTA is liberalized, this requirement is satisfied. However, some other countries objected and maintained the figure 90% or 95%. For example, the Japanese Government has taken a position that “substantially all” should mean at least 90% liberalization.

In the EEA Treaty between EC and some EFTA countries, there was no requirement that all of the trade between those entities is liberalized and, in a protocol attached to this treaty, it is provided that variable levies can be imposed on some agricultural products. Also in the

European Treaty between EC and East European countries, there was a special provision on agricultural products and tariffs and quantitative restrictions are not eliminated.

(b) Trade Remedy Approach

In this approach, one would eliminate all (or substantially all) of trade restrictions within a FTA including sensitive sectors. When an injury to a domestic industry of a party to the FTA occurs due to an increase of imports from other members of the FTA, that party utilizes trade remedy measures, i.e., safeguard, antidumping and countervailing duties. A question is whether, under Article XXIV of the GATT 1994, an application of safeguards, antidumping and countervailing duties can be made with respect to imports coming from other members of the FTA. The question is whether this application may be held contrary to the requirement that "substantially all" of internal trade should be liberalized.

Article XXIV: 8 of the GATT 1994 states that measures under Articles XI, XII, XIV, XV and XX of the GATT are exempted from the obligation to liberalize substantially all of the internal trade when forming a customs union or a free trade area. However, Article XIX of the GATT 1994 (safeguards) and Article VI of the GATT (antidumping and countervailing duties) are not specifically mentioned here. Therefore, an implication may be that, under Article XXIV of the GATT, members of FTA are not allowed to apply trade remedy measures as incorporated in Articles VI and XIX as against another member of the FTA.

It seems, however, that another interpretation may be worthy of consideration, e.g., that, under Article XXIV: 8 of the GATT 1994, a member of a FTA is not obligated to refrain from imposing safeguard, antidumping or countervailing duties on imports coming from other members of the FTA and, therefore, can impose them. First of all, safeguards, antidumping and countervailing duties can be characterized as measures which guarantee the smooth operation of free market and can be applied when market disruptions occur after liberalization of trade has taken place. The rationale of this interpretation is that trade remedies such as safeguards, antidumping and countervailing duties can be applied only where trade is free from quantitative restrictions, high tariffs and other trade restrictions. Trade remedies are a necessary concomitant to a liberal trade and, therefore there is no room for trade remedies to be applied, unless trade is substantially liberalized within a FTA. This interpretation would allow application of trade remedies within FTA.

Another question is whether a member of a FTA which is also a Member of the WTO violates Article I of the GATT (MFN principle) if that member applies safeguards, antidumping and countervailing duties to other WTO members which are not members of the FTA while not applying the same measures to members of the FTA. So far this question has been discussed as that of parallelism.

This issue was raised in the Argentina Footwear Case. In this case, Argentina applied safeguards on the imports of footwear. Argentina took into account the import of footwear from the MERCOSUR as well as imports coming from other WTO Members which were not members of the MERCOSUR when determining a serious injury to a domestic industry but did not apply a safeguard measure to the import from the members of the MERCOSUR. The EC challenged this practice at the WTO and both the Panel and the Appellate Body ruled that the selective application of safeguard measure by Argentina was contrary to Article 1 of GATT 1994 and

cannot be exempted under Article XXIV of the GATT. This ruling has been followed in the subsequent decisions of the Appellate Body including the recent US-Steel Safeguards Case.

5. How to Discipline FTAs?

FTAs are by nature exclusive and discriminatory. Therefore, if FTAs are left without any WTO disciplines, they may undermine the basis of the multilateral trading system as embodied in WTO. Therefore, some control is essential to keep them at bay.

(a) Restrictions Before and After the Formation of FTA

Article XXIV: 5(a) of the GATT states: "...with respect to a [FTA], the duties and other regulations of commerce imposed at the institution of any such [FTA] in respect of trade with contracting parties not parties to such [FTA] shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such [FTA]..." This provision is incorporated into Article XXIV: 5(a) of the GATT for the purpose of avoiding a situation in which parties to a FTA utilize the opportunity of the formation of a FTA to increase trade barriers as against outside parties.

In the Turkish-Textile Case, the issue was whether Turkey was justified in imposing a quantitative restriction on the import of textile products coming from third countries when it entered into a customs union agreement with the EC (the Ankara Agreement) to effectuate the quantitative restriction on textile products which the EC had been applying before the conclusion of this agreement. When Turkey imposed a quantitative restriction on imports of textiles coming from India, India claimed that it was a violation of Article XI of GATT 1994. Turkey argued that it was obligated to put into effect this restriction in order to comply with the Ankara Agreement whereby the EC and Turkey entered into a FTA. The Panel and the Appellate Body held that this imposition was contrary to Articles XI and XIII of the GATT 1994 and Article 2 of the ATC because Turkey could have used labeling requirement instead of import prohibition in order to comply with the provisions of the Ankara Agreement.

However, the Appellate Body stated that if a member of a FTA had no choice but to institute a restriction which would violate articles of the GATT in order to comply with a FTA which is duly formed, this would constitute a defense to a challenge by other WTO members that this constituted a violation of provisions of the GATT.

(b) Automatic Extension of Trade Remedies When a Member Joins FTA

One issue is automatic extension of a trade remedy measure when a new member joins a customs union. The question here is whether a customs union is allowed automatically to extend the coverage of a safeguard or antidumping measure that has been applied to the new entrant to the customs union. For example, when the EC has applied an antidumping measure to products from Japan and when a new member joins the EC, can the EC automatically extend the protection of this antidumping measure to this new member and impose antidumping duty on

product imported to the territory of this member from Japan? If this is allowed, this would mean that an antidumping duty is imposed on product from Japan imported into the territory of this new member without investigation. This is contrary to the principle of Antidumping Agreement that there should be no imposition of antidumping duty without investigation.

When three new members joined the EC and became a fifteen-member entity, the EC automatically extended the antidumping measure which had been imposed on products from Japan to the territories of those three new members. Japan objected and a negotiation was held between the EC and Japan in which a compromise was reached that the EC would, when requested, conduct a review of the totality of that antidumping measure at request. The position of Japan is that this automatic expansion of the antidumping measure is contrary to the requirement of Antidumping Agreement which requires a Member applying antidumping measures to conduct investigation before imposing a measure.

As mentioned earlier, if a member of a FTA exempts from trade remedy measures imports coming from other members of the FTA while not exempting imports coming from outside countries which are Members of WTO, this constitutes discrimination and amounts to a violation of Article 1 of GATT (MFN) or Article 2 of GATT (tariffs concession) as the case may be. The very purpose of such trade remedy is to provide relief to a domestic industry which is suffering from an injury due to a sudden increase of import or dumped subsidized imports. To exclude imports from members of the FTA totally from the application of trade remedy measures even if they are a cause of injury to the domestic industry simply because they are member of the FTA seems to be contrary to the very objective of trade remedy measures.

Article 802 of the NAFTA Treaty provides that a safeguard measure can be exempted in respect to members of NAFTA. If the above view on trade remedy measures is accepted, this NAFTA practice would be problematic under WTO. One may argue that this is contrary to Article 24.8(b). However, when a customs union has reached the level of integration envisaged in Article 24.8(a)(i), industries of a particular sector of members are deemed to have integrated into "the customs union industry" or "the Community industry" as in the case of EC. Under these circumstances, by definition, it is impossible to impose a safeguard measure or antidumping measure on imports coming from members of the union. An injury that may be caused by dumping from other members has to be dealt with as an issue of competition law.

Due to trade negotiations under GATT/WTO, the level of tariffs has been reduced considerably. Therefore, tariffs are less important as discriminatory features of a customs union or a free trade agreement. More important features will be those in the area of NTBs (non-tariff barriers) such as origin rules and technical barriers to trade.

6. Conclusion

The relationship between FTA agreements and the WTO is complex and, as examined above, there is much uncertainty in respect to this relationship. Now that multilateral negotiations are becoming more and more difficult, one should expect that there would be more FTA agreements in future. It is very important to maintain a balance between WTO disciplines and FTAs. A more comprehensive legal study in this area is highly recommended.

Navigating Rules of Origin: A Look at ASEAN

Written by

Samuel Scoles

Regional Director Asia, International Trade Services
White & Case LLP, Singapore

and

Linda Trutasnawint

International Trade Analyst
White & Case (Thailand) Limited

1. Introduction

With the collapse of the Doha negotiations and the waning faith in slow-moving multilateralism, bilateralism is on the rise and proliferating, particularly in the Asia-Pacific region. There are over 300 preferential trade agreements (PTAs) in progress worldwide, with Mongolia being the only World Trade Organization (WTO) member economy in the world without a PTA. Asian economies have been turning to PTAs to help drive trade growth and integration since the late 1990s. While this is a departure from past policies of open regionalism and unilateral liberalization, it is in line with the proliferation of PTAs worldwide. Most trade literature tends to describe bilateral PTAs as having more of a fragmenting than integrating effect, particularly because of these agreements' accompanying rules of origin (ROO). However, with the sufficient political will to overcome administrative obstacles, such as ROO and custom procedures, Asia and the ASEAN region in particular may emerge more integrated and unified to the extent that the realization of an Asia-Pacific common market is within grasp.

Asian Trade in Numbers

Asia has experienced spectacular trade expansion in the past two decades with exports growing nearly 10-fold over the period 1984 to 2004. This growth rate has outpaced world trade growth in which exports have only increased fivefold.[1] As Asia's world trade has expanded, so has its intraregional trade. The intraregional trade share in Asia has increased from approximately 40 percent in the early 1990s to 55 percent in 2004.[2] Looking within the ASEAN region, intra-

ASEAN imports grew at 19.3 percent, which was faster than the growth of total ASEAN trade at 15.9 percent in 2005. Despite the increase in intra-ASEAN trade volume, the share of intra-ASEAN to total ASEAN trade has remained relatively constant at 25 percent in 2005.

ASEAN has remained within an intra-ASEAN trade share band of approximately 20 percent of total ASEAN trade for the past two decades. This historically stable figure implies an inherent economic and trade structure, particularly the region's intra-industry and intra-firm network, which was established well before the ASEAN Free Trade Area (AFTA) in the mid-1980s. As ASEAN is moving toward more trade integration within the region, there is greater integration occurring with its Dialogue Partners (East Asia, India, the European Union, the United States, Australia and New Zealand), most of which are in the process of free trade negotiations.[3] Extra-ASEAN trade has more than doubled by 120 percent from approximately USD 347.5 billion in 1993 to USD 763.1 billion in 2004.[4] Trade integration with its Dialogue Partners is a natural extension of the existing trade pattern, economic structure, political alliances and geographical proximities. While moving towards consumption for economic growth, Southeast Asian economies are still highly driven by exports to the United States, the European Union, Japan and China. The Asian economies are also bound together by a tiered structure of economic development. If trade integration with its trading partners is a reaffirmation of the existing economic structure, then whether ASEAN can break out of the two decades old, intra-ASEAN trade share band of approximately 20 percent is questionable.

Global PTA Proliferation

In the aftermath of the Doha Round stalemate, bilateral PTAs are multiplying as economies seek timelier market access on their own opposed to indefinitely waiting for the conclusion of a multilateral agreement. The number of PTAs has multiplied from only 20 agreements notified to the WTO in 1981 to 197 agreements as of June 2006.[5] Including PTAs under negotiation and proposed, the number jumps to over 300 agreements as of July 2005.[6] Approximately 40 percent of world trade occurs between preferential trade partners. However, the Word Bank estimates that only half of this amount occurs under the respective PTA.[7] This underutilization of PTAs is often a result of complex ROO, which can place a costly administrative burden on individual companies that outweighs the benefits of the preferential rates. Because of this complexity, ROO are often used as a protective trade tool. With the growing number of PTAs and their accompanying ROOs adding complexity to the world trading system, many economists conclude that PTAs are oftentimes more of a stumbling block than a building block to regional trade integration.

Asian Integration through PTAs

Asian economies joined the proliferation bandwagon of PTAs in the late 1990s. As of September 2006, there are an estimated 41 signed PTAs, 31 under negotiation, and 47 under discussion coming to a total of 119 agreements (*see Appendix I*) within the Asia-Pacific region.[8] However, some ASEAN regional agreements may be counted as multiple bilateral agreements because both the products and product-specific rules vary from economy to economy despite the underlying framework. For example, the ASEAN-China Free Trade Agreement (ACFTA) may be counted as 10 separate deals between each ASEAN member economy and China. With four more regional agreements in the pipeline, including deals with Australia-New Zealand, India,

Japan and Korea, the number of bilateral agreements in Asia is multiplying at an explosive rate and with each bilateral, a varying set of ROO and administrative complexity. The overlapping tangle of agreements and different ROOs is known as the "noodle bowl"[9] or "spaghetti bowl"[10] effect.

2. Rules of Origin Characteristics

While economies may eliminate import duties under a PTA, they can still regulate market entry using various forms of ROO. A PTA may establish liberal origin criteria for less sensitive products or for products of particular export significance to a PTA partner. The opposite is also true whereby a PTA may have more stringent origin requirements for products domestically sensitive to a PTA partner. For example, sensitive products such as textiles and clothing usually have quite rigorous origin requirements, while those for electronic products are usually more liberal due in part to the globalized nature of electronics manufacturing and already low tariff levels. Moreover, most PTAs adopt the internationally accepted ROO principle identifying the economy of origin as the economy where the last 'substantial transformation' took place. There are three basic criteria used to determine whether a substantial transformation has occurred: (i) a change in tariff classification (at the 2-, 4- or 6-digit level); (ii) a minimum content of national or regional value-added (VA) to the manufactured product, whichever applies; and (iii) a process rule or technical requirement (TR).

There are three major types of preferential origin regimes in today's global trading system: (i) the Pan-European Rules of Origin or PERO model, led by the European Union,[11] (ii) the North American Free Trade Area or NAFTA model, led by the United States;[12] and (iii) what some would consider a new emerging Asian model, led by ASEAN itself.[13] The PERO and NAFTA models are more complex than ROO regimes in many Asian, African and Middle Eastern PTAs. The European Union and the United States are using these two models in agreements with partners in intercontinental agreements. ROO regimes in Asia are dominated by a simpler, broader value-added rule, which sometimes involve an alternative rule based on the change in tariff classification (CTC) criterion. However, the intercontinental ROO regimes of the US-Singapore, US-Australia, EFTA-Korea and Chile-Korea and other intercontinental PTAs have introduced additional complexity to the Asia-Pacific origin rules. ROO in these agreements tend to follow the NAFTA model, yet are notably less complex, featuring a strong CTC component. Some analysts contend that the PERO model will become more prevalent in the region, particularly as the European Free Trade Association (EFTA) and the European Union begin to negotiate more PTAs with Asian economies.[14] As ASEAN wraps up more FTA negotiations with its Primary Dialogue Partners (Australia-New Zealand, China, India, Korea, Japan), such agreements will help to determine whether a truly Asian or ASEAN ROO model might be emerging. Already, ASEAN has adopted product specific rules for many products in these agreements, introducing an alternative, usually PERO-type, free-standing value added rule, which instills generality and flexibility to the agreement.

3. The "Asian Noodle Bowl" Conundrum

ROO may be considered the necessary vice of PTAs.[15] While they are required to prevent trade deflection[16] and free riders, they add administrative burden and complexity, act as a transactional cost, increase the risk of trade and investment diversion, may be used as a protective trade instrument, and may ultimately decrease the usage and effectiveness of the agreement. The trade-off is that the more prescriptive and detailed the ROO, the more complicated and restrictive it becomes. Assuming protectionism is not an issue, PTAs must find the fine balance between preventing trade deflection and restricting trade to the extent that ROOs become a non-tariff barrier, which oftentimes defeats the purpose of the trade agreement itself and trade liberalization.

ROOs can become restrictive from administrative complexity and burdensome to customs administrations. In addition to a general framework, such as a local content requirement (LCR) percentage, ROOs usually have product-specific rules, which can range from 100 to 300 pages per agreement in Asian PTAs. Companies must bear the cost of compliance with ROOs, such as obtaining appropriate documentation, which acts similar to transportation cost. For example, a 2002 study found that the ROO-related administrative cost for Mexican exports to the United States under NAFTA was equivalent to approximately two percent of total costs.[17] The more limited a member's institutional capacity to implement ROO, the more expensive the cost. ROO can become administratively burdensome to multinational companies as different products are subject to different ROOs in each economy where the companies trade or maintain a production base. Given the fragmented nature of manufacturing in what has been called "Factory Asia,"[18] a single good can be produced in multiple economies, particularly for electronics and automotive products. Restrictive ROOs can also impede the integration of regional production networks and lower local value-added activities and investment.

Because restrictive ROOs can be used to alter trade and investment patterns, economies often use ROOs as a protective trade instrument for sensitive and/or infant industries. According to a statistical study of NAFTA, products with the most restrictive ROO often have the slowest tariff reduction schedule.[19] Article XXIV of GATT 1994 and Article V of the GATS set out rules governing the formation of customs unions and free trade areas pertaining to trade in goods and services respectively. The WTO, however, has been quite ineffective in controlling PTAs and ROOs. Many of the recent PTAs have not been notified to the WTO as required. The WTO has not been able to issue an examination report on a PTA since its single report in 1995 on the customs union between the Czech Republic and the Slovak Republic after the break up of Czechoslovakia.[20] While the WTO has created a set of harmonized non-preferential ROO, there has been no significant progress on the harmonization of preferential ROOs, to the best of our knowledge, because of the wide range of national interests and existing ROOs in practice.[21] Thus, national economies and companies are left to manage the impact of preferential ROOs on their own. The impact of ROO at the individual firm, regional and global levels is explained in further detail below.

ROO Impact at the Individual Firm Level

In one of many factors in a company's trade strategy, firms will continue to trade under a PTA as long as the cost of administering the ROO is less than the marginal rate of preference, or the

difference between the MFN rate and the preferential tariff rate. A case example is AFTA. In 2004, less than 10 percent of intra-ASEAN trade took place under the Common Effective Preferential Tariff (CEPT) agreement.[22] Many companies do not file for a certificate of origin (Form D), which is required to qualify for CEPT rates, because of complex paperwork requirements, time spent in face-to-face meetings with customs officials, and the low marginal rates of preference. While AFTA has brought down CEPT rates to 5 percent or less for 93 percent of the products on the CEPT inclusion list,[23] most member economies have also reduced their MFN rates from double digits in the early 1990s to today's average of approximately 5 percent for the ASEAN-5 (Indonesia, Malaysia, The Philippines, Singapore and Thailand) and 7 percent for all ASEAN members.[24] Thus, most companies have little incentive to file a Form D except for high-value goods and/or products in high-tariff sectors, such as auto parts.

In general, the implementation of the ROO requirements under the CEPT for AFTA face several difficulties including a lack of uniformity in implementation and interpretation, poor dissemination of information, consistency in the verification of the Form D Certificate of Origin, and lack of confidence in the maintenance of confidentiality of information submitted to authorities. As a result of these general difficulties, companies participating in the CEPT for AFTA face specific problems. For example, the CEPT ROO do not explicitly state the specific cost elements necessary for submitting manufacturing cost statements (MCS) for the calculation of local/ASEAN content. Thus, ASEAN members develop disparate interpretations of the requirements. The level of detail required in the MCS varies from economy to economy and can differ within each economy depending on the regional offices with which a company is dealing. There are more than 300 regional authorities issuing the Form D Certificate of Origin in Indonesia, and each authority may have different requirements as to the level of detail required in the MCS. For example, some do not require copies of the suppliers' invoice. In Singapore only the invoices of imported materials used in the manufacture of the products are required. In Malaysia, on the other hand, invoices of all raw materials are required to be included in the MCS submission.

Another difficulty relates to the free/freight on board (FOB) price calculation. The FOB price is required on the Form D Certificate of Origin and is based on the information provided when submitting the MCS. Because the FOB price may change after the submission of the MCS, problems may arise at the time of importation. Changes in FOB price can result in a discrepancy between the FOB value on the Form D Certificate of Origin and the invoice price. This may impact the customs valuation and origin information. In most economies, the relevant company will be required to resubmit its MCS to the issuing authority to correct the discrepancy. However, in Malaysia and Indonesia, if the change in FOB price is not caused by changes in the manufacturing cost, then no update of the MCS is required, and the company can change the FOB value on the Form D Certificate of Origin in accordance with the new invoice price. However, in some economies such as Thailand, Viet Nam and the Philippines the company will be required to resubmit its MCS to the issuing authority in the economy of export.

Finally, due to the nature of the business environment in ASEAN, many companies have expressed reluctance to disclose a detailed breakdown of their costs to government authorities. Many companies are skeptical that the confidentiality of the information provided in the MCS submitted to the issuing authority will not be compromised.

ROO Impact at the Regional Level

While PTAs increase the trade volume between preferential trading partners, they also divert trade and investment from non-preferential economies. Restrictive ROO encourage member economies to use intermediary goods originating within the member economies at the expense of non-member economies. Trade diversion occurs when member economies use intermediary goods from other member economies, although they may be less competitive than those of non-member economies, in order to meet the local content requirement and/or because the goods are subject to a lower preferential tariff rate. ROO can also cause investment diversion in which a non-member firm establishes a production facility in a member economy, which was not the optimal investment location, to satisfy ROO requirements. As ASEAN engages in inter-continental bilateral agreements, Asian economies are pitted against each other for non-Asian trade and investment often to the detriment of Asia's cross-border production area, which is instrumental to the region's economic development.

ROO Impact at the Global Level

Most economies start out their network of PTAs with trading partners in their geographical proximity. The evolving PTA network tends to be centered on the larger, industrial economy, such as the United States, or regional community, such as the European Union or ASEAN. Many analysts fear that PTAs will further the imbalance between developed and developing economies. In such a scenario, smaller economies will be locked into restrictive ROOs under a hub-and-spoke system in which the smaller economy is the "spoke" and the larger economy the "hub." The spokes are involved in agreements with the hub but not each other. Under an extortive system, the smaller economy is locked into trading with the larger economy, which has preferential access to the rest of its many spokes. The World Bank estimates that the hub-and-spoke system cost developing economies over USD 20 billion annually.[25]

Implications for ASEAN

ASEAN ROOs have the potential to become more complicated as they expand cross-regionally with the Dialogue Partners and inter-continentally with the United States, the European Union, as well as economies in Latin America and the Middle East. As larger economies have more bargaining clout, the ROO may lean in their favor and away from the loosely common ASEAN framework as the smaller economies are willing to give away more to gain access to the larger market. For example, Singapore has been on the forefront of signing FTAs and has already signed 10 agreements.[26] Each bilateral has a different local content requirement usually ranging from 30 to 60 percent. Notably, the two bilateral agreements that hit the 60 percent mark are the ones with Japan and the United States. The product-specific rules for the US-Singapore FTA were structured more along the lines of NAFTA's ROO, which are much more detailed, extensive and complex than those in most Asian FTAs.[27] As ASEAN is in the progress of negotiating cross-regionally and inter-continentally with larger markets, Asian economies are on the brink of proliferating ROOs that may be more restrictive and diverge from the simpler ASEAN ROO framework.

To ensure that ASEAN retains more bargaining power and remains consistent with the existing ROO structures, ASEAN has entered into negotiations as a region. This may be difficult given

the different tiers of development within ASEAN and individual economies' eagerness to conclude negotiations swiftly. Notably, the ADB reports that an ASEAN hub would eliminate more trade distortions than a single-economy hub and would result in 70 percent of the benefits of a region-wide FTA.

4. ASEAN's Strategies on Rules of Origin

As part of efforts to strengthen cooperation and support economic stability in East Asia and the Pacific, ASEAN is in various stages of negotiation with five of its 10 Dialogue Partners (namely Australia/New Zealand, China, India, Japan and Korea) to establish free trade agreements (FTAs) and closer economic partnerships (CEPs). FTA negotiations with China and Korea are the most advanced, with both sides having signed a Trade in Goods (TIG) Agreement.[28] These two agreements provide up-to-date and relevant insight to ASEAN's preferred approaches, priorities and sensitivities with regard to FTA/CEP negotiations. Negotiations with the other Dialogue Partners, such as India, Japan and Australia/New Zealand, are progressing more slowly. In fact, many analysts contend that the lack of consensus on ROO has been a primary reason for the slow progress of negotiations on the ASEAN-India Free Trade Area (AIFTA)[29] and the ASEAN-Japan Comprehensive Economic Partnership (AJCEP).

CEPT Rules of Origin

The general rule for conferring origin under the CEPT Scheme since its inception in 1993 is based on the 40 percent value-added criterion. ASEAN has also adopted substantial transformation – as an alternative criterion to the general rule – for selected products to keep pace with the changing global and regional environment. ASEAN currently has substantial transformation rules for wheat flour, wood-based products, aluminum products, as well as iron and steel. Most of these substantial transformation rules utilize the CTC approach.

ASEAN is currently guided by the broad principle that any rules of origin it concludes with a Dialogue Partner should be consistent with the Rules of Origin for the CEPT Scheme for AFTA and its corresponding Operational Certification Procedures (CEPT Rules of Origin). ASEAN believes such an approach will *inter alia* facilitate the implementation of the FTAs and CEPs since manufacturers, traders and customs officials in the region are most familiar with this set of rules and procedures. It is based on this rationale that the first rules of origin concluded between ASEAN and a Dialogue Partner, *i.e.* the Rules of Origin for the ACFTA and its corresponding Operational Certification Procedures (ACFTA Rules of Origin), closely follow the CEPT Rules of Origin – with some variations.

Towards Harmonization

As ASEAN began negotiating more FTAs and CEPs, it realized that other Dialogue Partners preferred to adopt ROO that differed to some extent from the CEPT Rules of Origin, *e.g.* CTC. Thus, in an attempt to move FTA/CEP negotiations forward, ASEAN member economies are assessing their respective positions to try and formulate a collective strategy for negotiating

rules of origin with Dialogue Partners. Such an undertaking will take some time to complete since it involves 10 member economies in various stages of development and with very different concerns (*see Appendix 2*).

The eventual collective strategy of ASEAN is likely to allow for more flexibility and options in determining the FTA/CEP rules of origin with Dialogue Partners, while still maintaining some form of consistency with the CEPT Rules of Origin. This means that ASEAN will still try to maintain the 40 percent value-added criterion as the general rule in its FTAs/CEPs with Dialogue Partners, but agree to negotiate product specific rules (PSR) based on other rules of origin criteria for certain products. This is also evident in the transformation of the CEPT Rules of Origin to include substantial transformation rules as illustrated above. Moreover, ASEAN appears to support the general principle that ROO in ASEAN should be as liberal, if not more liberal, than the ROO in ASEAN's FTAs with Dialogue Partners. ASEAN officials are currently discussing the development of PSR as an alternative criterion to the general rule of 40 percent. The revised CEPT Rules of Origin will likely be used as a benchmark in ASEAN FTA negotiations with Dialogue Partners and continuously reviewed to keep pace with current developments.

While waiting for ASEAN to formulate its collective strategy for negotiating ROO with Dialogue Partners, the ACFTA and AKFTA Rules of Origin provide a fair gauge of ASEAN's general position. The ACFTA also provides a good indication of the products, which ASEAN member economies will likely request for delayed tariff liberalization in FTAs/CEPs with other Dialogue Partners.

Trade Facilitation and Customs Reform

ASEAN is also placing more emphasis on trade facilitation as a strategy that will enable ASEAN to reduce trade transaction costs and enhance its competitiveness – in a sense integrating ASEAN into one seamless market for goods, services and investment. This is in line with ASEAN's plans to establish an ASEAN Economic Community (AEC) in the next decade. As the number of bilateral and regional FTAs proliferates in Asia, ASEAN remains guided by several key principles, including strengthening the AEC, emphasizing the centrality of ASEAN as a hub in regional cooperation and processes with Dialogue Partners, and prioritizing FTAs with those economies/regions with which ASEAN can derive the most benefit.

ASEAN has recognized the need to deepen trade integration through the harmonization and simplification of operational procedures, including rules of origin. Indeed, the introduction of the ASEAN Harmonized Tariff Nomenclature (AHTN) system in January 2004 eliminated the problem of different classification codes for each member economy. In December 2005, ASEAN agreed to implement the ASEAN Single Window (ASW) to simplify and expedite custom procedures by 2008 for Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand, and by 2012 for Cambodia, Laos, Myanmar and Viet Nam. Individual member economies are developing their National Single Window (NSW), which will later be incorporated into ASW. A task force has developed the implementing Protocol, Technical Guide, NSW Implementation Guide and the ASW Action Plan.

5. Prospects for Harmonized Rules of Origin and an Integrated ASEAN

ASEAN is moving surely and determinedly towards regional integration. The interlinked issues that remain include: (i) the practical administrative issues to ensure the smooth flow of trade and investment; (ii) the political will and institutional capability to implement technical resolutions; and (iii) the timeliness of realistically achieving administrative harmonization and trade integration. If ASEAN can jump these sizable hurdles to achieve deeper regional integration, the AEC can become a reality and not just a vision statement.

An ASEAN Hub

ASEAN is emerging as the hub in Asia, not only because of a relatively successful AFTA and a network of FTA negotiations, but also because it politically plays well within the region's balance of power. Although hubs usually are the largest economy within a region, ASEAN has surfaced as a key player alongside China, Japan and India. ASEAN had the advantage of being active in regional trade agreements early on in the game. ASEAN was created in 1967; APEC was created in 1989; and AFTA was signed in 1992. As such, a successful regional agreement already exists to build upon. China only proposed ACFTA in 2000 to engage its trade partners and allay their fears of Chinese competition. Shortly after, Japan, Korea and India began their respective dialogues with ASEAN.

As ASEAN member economies phase out their bilateral agreements into regional ASEAN Plus agreements, they must ensure that they collectively hold their weight against the larger non-ASEAN economies. Looking at the common ROO framework that is emerging in its negotiations with the Dialogue Partners, ASEAN appears to be successfully maintaining its position in the negotiations. It is trying to ensure that ASEAN as a region is put first before national interests and maintains preference throughout all of the Dialogue agreements. Still, a concrete conclusion has yet to be reached, which is reflected in the slow pace of the negotiations. Until a solid regional strategy and the Dialogue agreements are concluded, ASEAN will most likely not be in a rush to conclude inter-continental negotiations with the United States and the European Union. In the meantime, individual ASEAN economies will likely continue their separate bilateral negotiations in their bid for market access – adding more types of ROOs to the mix.

Many observers become increasingly apprehensive looking at the daunting task of harmonizing the myriad of complex ROOs. However, there may be a misconception that a harmonized ROO would be a single set of the exact same rules for all Asian economies in one 'big noodle,' which would be next to impossible with conflicting national interests. Rather, harmonization could be possible having a common framework, such as the type of ROO characteristics used and the local content requirement, that could accommodate the different national interests reflected in the different product-specific rules. Harmonization could be approached as building a cable organizer (or framework) for the different ROOs, instead of chasing 'noodle ends.'

The Timeliness of the ASEAN Way

ASEAN has recognized and is working towards harmonization. The question remains whether ASEAN can achieve harmonization on a timely basis, particularly as the ASEAN Way has never been the fastest way. ASEAN was originally constructed as a security arrangement that was highly successful because it recognized the sovereignty of its members. Decisions are made based on informality, conflict avoidance and consensus. Many initiatives take a decentralized, bottoms-up approach. Even the ASEAN Single Window for customs procedures is being developed at the national level first before being incorporated as a regional system. While this decentralized approach allows economies to develop what they can with their available resources, it is not the quickest way to develop a common standard. The expedited harmonization of administration issues usually appears to be the most efficient from the top-down, particularly in the management of conflicting national interests. However, ASEAN does not have an empowered supranational institution. The ASEAN Secretariat merely has a facilitation and coordination function. The issue remains whether ASEAN can complete the harmonization of ROO and customs procedures on a timely basis before negotiation fatigue sets in as each economy races for its own bilateral agreements with the Dialogue Partners.

6. Conclusion

The proliferation of bilateral and regional trade agreements in Asia signals the strategic, political and commercial interests of economies to establish a market-driven integration process; however, this is often times at the cost of a common agenda. The real challenge for ASEAN lies in harmonizing the various agendas to expand the reach of integration to encompass both national and regional goals. Navigating the maze of rules of origin has made international trade more costly and increasingly complex for exporters with many foreign markets, importers of intermediary materials for the purpose of re-exporting products, and national customs administrations.

ROOs have a significant impact upon the strategic planning of firms that want to maximize their profits. They can divert trade flows and industry investment in infrastructure from a more competitive non-PTA economy to economies that are not the optimal location because of PTA incentives. As such, restrictive ROOs and PTAs can fragment Asia's intra-industry and intra-firm network, which has played a large role in the Asian economic miracle and in driving today's trade flows. However, if economies in the Asia Pacific can solve the practical behind-the-border issues of daily trade, particularly ROO and customs administration, and garner sufficient political will, they can use PTAs as a stepping stone to deeper regional integration.

APPENDIX 1: Preferential Trade Agreements (PTAs) Involving Asia-Pacific Economies as of September 2006

PREFERENTIAL TRADE AGREEMENTS ESTABLISHED (year into force)

Regional Trade Agreements

AFTA:	ASEAN Free Trade Area (1992)
ACFTA:	ASEAN-China Free Trade Agreement, Trade in Goods (2004)**
AKFTA:	ASEAN-Korea Free Trade Agreement, Trade in Goods, except Thailand (2006)*
APTA:	Asia Pacific Trade Agreement or Bangkok Agreement (1976, 2002)
SAFTA:	South Asian Free Trade Area (2006)
SAPTA:	SAARC Preferential Trading Arrangement (1995)
TPSEP:	Trans-Pacific Strategic Economic Partnership Agreement (2006)*

Bilateral Trade Agreements

Australia-New Zealand (1983)	India-Sri Lanka (2000)	Singapore-Jordan (2005)*
Australia-United States (2005)	Japan-Malaysia (2006*)	Singapore-New Zealand (2001)
China-Chile (2006)*	Japan-Mexico (2005)	Singapore-Panama (2006)*
China-Hong Kong, China SAR (2004)	Japan-Philippines (2006)*	Singapore-United States (2004)
China-Macao SAR (2004)	Japan-Singapore (2002)	Chinese Taipei-Guatemala (2005)*
China-Pakistan (2006)* **	Korea-Chile (2004)	Chinese Taipei-Nicaragua (2006)*
China-Thailand (2003)* **	Korea-EFTA (2006)	Chinese Taipei-Panama (2004)*
India-Afghanistan (2003)*	Korea-Singapore (2006)	Thailand- Australia (2005)
India-Bhutan (1995)*	Laos- Thailand (2001)	Thailand- New Zealand (2005)
India-MERCOSUR (2005)*	Malaysia-Pakistan (2006)* **	Thailand-India (2004)* **
India-Nepal (1996)*	Singapore- Australia (2003)	
India-Singapore (2005)*	Singapore-EFTA (2003)	

Notes: * not notified to WTO ** Early Harvest Program in effect, negotiations still in progress

PREFERENTIAL TRADE AGREEMENTS UNDER NEGOTIATION

Regional Trade Agreements

AANZFTA:	ASEAN-Australia and New Zealand Free Trade Agreement
AIFTA:	ASEAN-India Free Trade Agreement
AJCEP:	ASEAN-Japan Comprehensive Economic Partnership
BIMSTEC:	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation

Bilateral Trade Agreements

Australia-Malaysia	Japan-Indonesia	Singapore-Pakistan
China-Australia	Japan-Thailand	Singapore-Peru
China-Gulf Cooperation Council (GCC)	Korea-Canada	Singapore-Qatar
China-New Zealand	Korea-United States	Chinese Taipei-El Salvador
India-Bangladesh	Malaysia-United States	Chinese Taipei-Honduras
India-Chile	New Zealand-Malaysia	Thailand-Bahrain
India-Egypt	Singapore-Canada	Thailand-EFTA
India-GCC	Singapore-Kuwait	Thailand-Peru
Japan-Chile	Singapore-Mexico	Thailand-United States

PREFERENTIAL TRADE AGREEMENTS UNDER DISCUSSION

Regional Trade Agreements

ASEAN+3 (ASEAN-China-Japan-Korea)

ASEAN-United States EAI (Enterprise for ASEAN Initiative)

EAFTA (East Asia Free Trade Area)

Bilateral Trade Agreements

Australia-Chile	India-Pakistan	Malaysia-Korea
Australia-GCC	India-SACU	Malaysia-Chinese Taipei
China-Caribbean Economies	Indonesia-Australia	New Zealand-GCC
China-Central Asia	Indonesia-Bangladesh	Philippines-Canada
China-Iceland	Indonesia-Iran	Philippines-Mexico
China-India	Indonesia-Pakistan	Philippines-United States
China-Japan	Japan-Australia	Singapore Bahrain
China-Korea	Japan-Brunei Darussalam	Singapore-China
China-MERCOSUR	Japan-India	Singapore-Egypt
China- Southern African Customs Union (SACU)	Japan-Korea	Singapore-Sri Lanka
China-South Africa	Japan-Viet Nam	Singapore-UAE
Hong Kong, China-New Zealand	Korea-Mexico	Chinese Taipei-US
India-Korea	Korea-Philippines	Thailand-Chile
India-Malaysia	Malaysia-Bangladesh	Thailand-Pakistan
India-Mauritius	Malaysia-Chile	

Agreement	Member Economies
ASEAN	Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam
APTA	Bangladesh, China, India, Korea, Laos, Sri Lanka
BIMSTEC	Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, Thailand
EAFTA	ASEAN, Australia, China, Japan, Korea, India, New Zealand
EFTA	Iceland, Liechtenstein, Norway, Switzerland
GCC	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates
MERCOSUR	Argentina, Brazil, Paraguay, Uruguay, Venezuela
SACU	Botswana, Lesotho, Namibia, South Africa, Swaziland
SAFTA	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
SAPTA	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
TPSEP	Brunei Darussalam, Chile, New Zealand, Singapore

Sources: Feridhanusetyawan, Tubagus, "Preferential Trade Agreements in the Asia-Pacific Region," IMF Working Paper, WP/05/149, Intereconomyal Monetary Fund, July 2005; ADB staff writers, "Asia Development Outlook 2006: Route's for Asia's Trade," Asian Development Bank, 2006; Wagle, Swarnim, “Assessing New Regionalism in its Entirety,” UNDP Asia-Pacific Regional Centre, Colombo, 2-3 February 2006; WTO, “Regional Trade Agreements Notified to the GATT/WTO and in Force as of 15 June 2006,” http://www.wto.org/english/tratop_e/region_e/eif_e.xls, accessed 1 September 2006; authors’ own listings.

APPENDIX 2: Status of ASEAN FTAs with Dialogue Partners, Including Rules of Origin

**negotiations on rules of origin ongoing and subject to changes*

	ASEAN Coordinator	Basis for FTA Negotiations	Timeframe for Realizing the FTA	Latest Meeting
AFTA	*n/a*	*Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area* (signed: 28 January 1992)	• Between 1 January 1998 and 1 January 2001- ASEAN 6 • 1 January 2006 – Viet Nam • 1 January 2008 - Laos and Myanmar • 1 January 2010 - Cambodia	20th Meeting of the AFTA Council 21 August 2006 Kuala Lumpur, Malaysia
CHINA	Thailand	*Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China* (signed: 4 November 2002)	• 1 January 2010 – ASEAN 6 and China • 1 January 2015 – Cambodia, Laos, Myanmar, Viet Nam ("CLMV")	23rd Meeting of the AC-TNC 12-14 July 2006 Jakarta, Indonesia
INDIA*	Malaysia	*Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India* (signed: 8 October 2003)	• 31 December 2011 – Brunei Darussalam, Indonesia, Malaysia, Singapore, Thailand and India • 31 December 2016 – Philippines and CLMV	13th Meeting of the AI-TNC 15-17 June 2006 Singapore
JAPAN*	The Philippines	*Joint Declaration of the Leaders on the Comprehensive Economic Partnership between ASEAN and Japan* (signed: 5 November 2002) *Framework for Comprehensive Economic Cooperation between ASEAN and Japan* (signed: 8 October 2003)	• 2012, taking into account the economic levels and sensitive sectors in each economy, including allowing additional five years' time for CLMV	5th Negotiating Session for the AJCEP 31 July - 1 August 2006 Jakarta, Indonesia
KOREA	Singapore	*Joint Declaration on Comprehensive Cooperation Partnership between ASEAN and Korea* (signed: 30 November 2004) *ASEAN-ROK Experts Group Joint Study of Comprehensive Closer Economic Relations between ASEAN and Korea*	• 1 January 2008 – Korea* • 1 January 2010 – ASEAN 6* • 1 January 2016 – Viet Nam • 1 January 2018 – CLM * *with flexibility to 2010 for Korea and 2012 for ASEAN 6.*	14th Meeting of the AK-TNC 18-22 September 2006 Bali, Indonesia
AUSTRALIA / NEW ZEALAND*	Brunei Darussalam	*Joint Declaration of the Leaders at the ASEAN-Australia and New Zealand Commemorative Summit* (signed: 30 November 2004)	• Within 10 years (specific year still under discussion)	7th Meeting of the AANZ-TNC 26-29 September 2006 Hobart, Australia

AUSTRALIA / NEW ZEALAND*	KOREA	JAPAN*	INDIA*	CHINA	AFTA	
• ASEAN, Australia and New Zealand have reached consensus on some of the common elements of the modality for the TIG Agreement. • The parties will continue to discuss the details of the common elements, specifically: treatment of tariff lines, coverage and depth of commitments within the 10 year timeframe, liberalization modalities for sensitive products, and the modality for TRQ negotiations.	• Because of Thailand's domestic situation, Thai officials have not yet indicated a date when they can sign the TIG Agreement. • Notwithstanding the finalization of the exchange of notes for the Gaesong Industrial Complex, ASEAN members must still complete their individual lists of products to be covered under the TIG Agreement.	• Both sides have conducted workshops in order to gain a better understanding on Japan's modality for regional tariff concessions as well as on the rules of origin. • Both sides have tabled their respective guidelines/basic principles on modalities for tariff reduction although they have not yet reached a consensus on an agreed-upon set of modalities.	• Negotiations for the TIG Agreements have been stalled over India's exclusion list, which continues to be long and includes products of major export interest to ASEAN. • On 18 August 2006, India made an offer to reduce its negative list to 560 items and to cut tariffs on 94.6 percent of ASEAN exports. ASEAN is concerned with when these concessions will take effect. ASEAN is still in the process of evaluating India's offer. • The *Protocol to Amend the Framework Agreement* and implementation of the AIFTA (*i.e.* 1 January 2007) has not yet been signed.	• The WG has drafted Interpretative Notes to paragraph 6, Annex 2 of the TIG Agreement. Once the TNC endorses them, these notes will be submitted to the AEM-China Consultations in Kuala Lumpur for endorsement. • Thailand and China have yet to complete their bilateral discussions on the treatment of products subject to tariff rate quotas ("TRQs"). • Cambodia remains the only ASEAN economy that as of 7 July 2006 has not completed its internal ratification procedures to implement the TIG Agreement.	• Members have agreed to eliminate the CEPT rates for all products covered by the Priority Integration Sectors ("PIS") by 1 January 2007. • The 12 PIS and corresponding coordinators are: (i) wood-based products and automotive (Indonesia); (ii) rubber-based products as well as textiles and apparel (Malaysia); (iii) agro-based products and fisheries (Myanmar); (iv) electronics (Philippines); (v) e-ASEAN and healthcare (Singapore); (vi) air travel and tourism (Thailand); and logistics (Viet Nam).	**Trade in Goods**
Rules of Origin						
The AANZFTA will likely recognize wholly obtained or produced as a basic criteria for determining origin. Products that are wholly produced or obtained from Australia and New Zealand or an ASEAN member economy are considered originating including products that are harvested, picked, gathered, obtained, taken from either Australia and New Zealand or an ASEAN member economy.	The AKFTA will likely recognize wholly obtained or produced as a basic criteria for determining origin. Products that are wholly produced or obtained from Korea or an ASEAN member economy are considered originating including products that are harvested, picked, gathered, obtained, taken from either Korea or an ASEAN member economy.	The AJCEP will likely recognize wholly obtained or produced as a basic criteria for determining origin. Products that are wholly produced or obtained from Japan or an ASEAN member economy are considered originating including products that are harvested, picked, gathered, obtained, taken from either Japan or an ASEAN member economy.	The AIFTA will likely recognize wholly obtained or produced as a basic criteria for determining origin. Products that are wholly produced or obtained from India or an ASEAN member economy are considered originating including products that are harvested, picked, gathered, obtained, taken from either India or an ASEAN member economy.	The ACFTA recognizes wholly obtained or produced as a basic criteria for determining origin. Products that are wholly produced or obtained from China or an ASEAN member economy are considered originating including products that are harvested, picked, gathered, obtained, or taken from either China or an ASEAN member economy.	The AFTA recognizes wholly obtained or produced as a basic criteria for determining origin. Products that are wholly produced or obtained from an ASEAN member economy are considered originating including products that are harvested, picked, gathered, obtained, or taken from another ASEAN member economy.	**Wholly-Produced or Obtained Criteria**

AUSTRALIA / NEW ZEALAND*	KOREA	JAPAN*	INDIA*	CHINA	AFTA	
General rule based on calculation of local content plus product specific rules ("PSR") **PSR** Australia and New Zealand have proposed draft PSR based on the CTC Approach.	General rule based on calculation of local content plus product specific rules ("PSR") **PSR** Appendix 2 includes over 51 pages of PSR.	General rule based on calculation of local content plus product specific rules ("PSR") **PSR** ASEAN has proposed using PSR as a derogation rule.	General rule based on calculation of local content plus product specific rules ("PSR") **PSR** Certain products will be subject to PSR; however, these have not been finalized.	General rule based on calculation of local content plus product specific rules ("PSR") **PSR** First Package of PSR includes 424 items (in 6-digit Harmonized System ("HS") code) of textile and textiles products (HS Chapter 52 and 60-63), two items of preserved fish (HS Chapter 16), six items of wool (HS Chapter 51), 22 item lines of leather goods (HS Chapter 42), 14 items of furskins (HS Chapter 43) and four items of footwear (HS Chapter 64).	General rule based on calculation of local content plus product specific rules ("PSR"). **PSR** ASEAN members are currently negotiating PSR for wood-based products, aluminum, wheat flour, and iron and steel.	**Method of Determining Origin**
ASEAN has proposed a general rule of 40%. Australia and New Zealand have in principle agreed to the proposal.	40%	ASEAN has proposed a general rule of 40%. Japan has in principle agreed to the proposal.	35%	40%	40%	**Minimum Threshold for Local Value-Add Required**
ASEAN has proposed Change in Tariff Classification ("CTC"). ASEAN, Australia and New Zealand are still engaged in ROO determination negotiations.	ASEAN has proposed Change in Tariff Classification ("CTC"). (Value of non-AKFTA materials + Value of materials of undetermined origin) / FOB Price x 100% < 60 AKFTA content is thus (100% - non-AKFTA material) = at least 40%	ASEAN has proposed Change in Tariff Classification ("CTC"). ASEAN and Japan are still engaged in ROO negotiations.	Change in Tariff Sub-Heading ("CTSH"). (Value of non-AIFTA materials + Value of materials of undetermined origin) / FOB Price x 100% < 65 AIFTA content is thus (100% - non-AIFTA material) = at least 35%	Cost, insurance, freight ("CIF") value and Freight on Board ("FOB") value. (Value of non-ACFTA materials + Value of materials of undetermined origin) / FOB Price x 100% < 60 ACFTA content is thus (100% - non-ACFTA material) = at least 40%.	Freight on Board ("FOB") value. (Value of non-AFTA materials + Value of materials of undetermined origin) / FOB Price x 100% < 60 AFTA content is thus (100% - non-AFTA material) = at least 40%	**Basis of Calculation Minimum Threshold for Local Value-Add Required**
Products that comply with origin requirements and are used either in Australia/New Zealand or ASEAN as materials for a finished product eligible for preferential treatment are considered originating. One requirement is that the aggregate AANZFTA content on the final product is not less than 40 percent.	Products that comply with origin requirements and are used either in Korea or ASEAN as materials for a finished product eligible for preferential treatment are considered originating. One requirement is that the aggregate AKFTA content on the final product is not less than 40 percent.	Products that comply with origin requirements and are used either in Japan or ASEAN as materials for a finished product eligible for preferential treatment are considered originating. One requirement is that the aggregate AJCEP content on the final product is not less than 40 percent.	Products that comply with origin requirements and are used either in India or ASEAN as materials for a finished product eligible for preferential treatment are considered originating. One requirement is that the aggregate AIFTA content on the final product is not less than 35 percent.	Products that comply with origin requirements and are used either in China or ASEAN as materials for a finished product eligible for preferential treatment are considered originating. One requirement is that the aggregate ACFTA content (*i.e.* full cumulation applicable among China and ASEAN Members) on the final product is not less than 40 percent.	The aggregate content (*i.e.* full cumulation applicable among ASEAN Members) on the final product is not less than 20 percent.	**Cumulative Rule of Origin/ Partial Cumulation**

[1] ADB staff writers, "Asia Development Outlook 2006: Route's for Asia's Trade," Asian Development Bank, 2006
[2] ADB, "ADB Strategy Paper: Regional Cooperation and Integration," Office of Regional Economic Integration, Asian Development Bank, May 2006
[3] ASEAN has ten Dialogue Partners, sometimes called the ASEAN 10+10. The Dialogue Partners that are in active trade negotiations or have signed some sort of agreement are Australia, China, the European Union, India, Japan, New Zealand, Korea and the United States. The remaining two partners are Canada and the Russian Federation.
[4] Staff Writers, "Radifah's Response on the Way Forward for ASEAN," *Bernama*, 18 August 2006
[5] WTO, "Regional Trade Agreements Notified to the GATT/WTO and in Force as of 15 June 2006," http://www.wto.org/english/tratop_e/region_e/eif_e.xls, accessed 1 September 2006
[6] WTO, "WTO Hong Kong, China Ministerial Meeting Briefing Notes: Regional Agreements – Building Blocks of Stumbling Blocks," http://www.wto.org/english/theWTO_e/minist_e/min05_e/brief_e/brief09_e.htm
[7] Carstens, Agustin, "Making Regional Economic Integration Work," Speech at the 20th Annual General Meeting and Conference of the Pakistan Society of Development, International Monetary Fund, Islamabad, 12 January 2005
[8] For the purpose of this paper, the Asia-Pacific region covers the ten ASEAN member economies (Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, The Philippines, Singapore, Thailand and Viet Nam), China, Japan, Korea, Chinese Taipei, Australia, New Zealand and India. The number of agreements counted under the Asian Development Bank (ADB) and its broader definition of Asia amount to 81 agreements under implementation, 52 under negotiation and 50 under proposal.
[9] Richard E. Baldwin, "Managing the Noodle Bowl: The Fragility of East Asian Regionalism," Graduate Institute of International Studies, Geneva, January 2006, and Haruhiko Kuroda, "Trade Policy Trends: Serving the Business Interests," Speech at the Asia-Europe Business Forum, Asian Development Bank, Helsinki, 10 September 2006
[10] Bhagwati, Jagdish , "From Seattle to Hong Kong," WTO Special Edition, *Foreign Affair*s, December 2005
[11] The PERO model is used across the EU's free trade agreements. In 1997, the Pan-European (PANEURO) system established identical rules of origin protocols and product-specific rules across Europe's existing FTAs. The PERO model consists of "diagonal cumulation" among participating economies (*i.e.* the EU, Bulgaria, Switzerland, Liechtenstein, Iceland, Norway, Romania and Turkey). Products are considered as originating in the EU if they are "obtained" (*i.e.*, produced) in the EU from materials originating in any of the other participating economies.
[12] The NAFTA model is complex and is based on the change in tariff classification at the chapter, heading, subheading or item level, depending on the product. Moreover, many products combine the change in tariff classification requirement with an exception, regional value content and / or technical requirement.
[13] This simpler ROO model is based on a value-added criterion and may include product specific rules that involve a change in tariff classification at the heading or subheading level.
[14] EFTA has concluded FTAs with Korea and Singapore and is currently negotiating with Thailand.
[15] Rules of origins are required only as long as MFN tariff rates remain above zero percent, which maintains the preferential nature of the agreement.
[16] Trade deflection occurs through transshipment of goods by a non-member party to a member economy to take advantage of the preferential tariff rates under the PTA.
[17] Cadot, Oilver, Jaime de Melo, Antoni Estevadeordal, Akiko Suwa-Eisenmann and Balormaa Tumurchudur, "Assessing the Effect of NAFTA's Rules of Origin," Mimeo, 2002
[18] Baldwin, Richard E., "Managing the Noodle Bowl: The Fragility of East Asian Regionalism," Graduate Institute of International Studies, Geneva, January 2006
[19] Weiler, J.H.H, and Sungjoon Cho, "Unit III: Rules of Origin" in *International and Regional Trade Law: The Law of the World Trade Organization*, NYU School of Law, 2004, p. 19
[20] Lamy, Pascal, "Lamy welcomes WTO agreement on regional trade agreements," 10 July 2006, http://www.wto.org/english/news_e/news06_e/rta_july06_e.htm; WTO, "Work of the Committee on Regional Trade Agreements" webpage, http://www.wto.org/english/tratop_e/region_e/regcom_e.htm, accessed 14 September 2006
[21] The WTO has had an "Agreement on the Rules of Origin" since 1994. The Agreement's main objective is to harmonize non-preferential ROO and ensure that they do not create additional barriers to trade. Preferential ROO are covered under Annex II of the Agreement; however, the wording of the text is ambiguous and subject to various interpretations. Annex II requires that ROO clearly define the requirements, are based on a positive standard, comply with paragraph 1 of Article X of GATT, and are implemented promptly after the PTA goes into effect. Source: Annex II-Common Declaration with Regard to Preferential Rules of Origin, WTO Agreement on Rules of Origin.
[22] Staff writers, "Free Trade in South-East Asia," *The Economist*, 29 July 2004
[23] As of 1 January 2005, ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, The Philippines, Singapore and Thailand) members reduced 98.98 percent of products listed on the CEPT inclusion list (IL) to 5 percent or less. Newer ASEAN members (Cambodia, Laos, Myanmar and Viet Nam) have done the same for 86.91 percent of their products. In total, 92.99 percent of products in the IL list have tariffs between 0 and 5 percent. Regarding the IL list, in August 2006, the Malaysian Ministry of Trade and Industry announced that all ASEAN member economies have transferred products in the Temporary Exclusion List and the Sensitive List to the CEPT IL. Products on the Highly Sensitive List, such as rice, will be incorporated into the IL by 2010.
[24] Average MFN figures for individual economies sourced from UNCTAD/WTO Market Access Map,

http://www.macmap.org/, accessed 17 August 2006.

[25] The Economist staff writers, "Least favoured nation," *The Economist,* 3 August 2006.

[26] As a small, open economy, Singapore's best trade policy would be to gain more market access through FTAs. Thus, this small economy has been the most active ASEAN member in pursuing bilateral agreements.

[27] Productivity Commission, "Restrictiveness Index for Preferential Rules of Origin," Supplement to Productivity Commission Research Report, *Rules of Origin under the Australia—New Zealand Closer Economic Relations Trade Agreement*, Australian Government Productivity Commission, Canberra, June 2004; and Productivity Commission, *Trade & Assistance Review 2003-04*, Annual Report Series 2003-04, Australian Government Productivity Commission, Canberra, December 2004.

[28] Thailand has not signed the TIG under the AKFTA due to differences with Korea over the inclusion of rice in Korea's exemption list.

[29] Consensus on ROO has now been reached under the AIFTA negotiations.

Who Benefits from RTA Dispute Settlement Procedures?

Written by

Yuka Fukunaga

Associate Professor, School of Social Sciences
Waseda University

1. Introduction

The World Trade Organization (WTO) dispute settlement system has been remarkably successful in resolving disputes and securing compliance with the WTO Agreement. This system is undoubtedly one of the most effective dispute settlement systems in international society.

Despite the success of the WTO dispute settlement system, most regional trade agreements (RTAs) contain their own dispute settlement procedures. Are WTO Members not satisfied with the WTO dispute settlement system? What are the differences between the WTO dispute settlement system and RTA dispute settlement procedures? In particular, who benefits from having additional dispute settlement procedures in RTAs? This paper addresses these questions with a particular focus on the RTAs signed by Japan.

2. Dispute Settlement Provisions in the RTAs Signed by Japan

This section gives an overview of the dispute settlement provisions of the RTAs signed by Japan.

It is relatively recently that Japan has been actively negotiating RTAs. Japan has signed four RTAs: Agreement between Japan and Singapore for a New-Age Economic Partnership [hereinafter Japan-Singapore RTA][1] (signed January 2002, effective November 2002); Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership [hereinafter Japan-Mexico RTA][2] (signed September 2004, effective April 2005); Agreement between the Government of Japan and the Government of Malaysia for

an Economic Partnership [hereinafter Japan-Malaysia RTA][3] (signed December 2005, effective July 2006); Agreement between the Government of Japan and the Government of the Philippines for an Economic Partnership [hereinafter Japan-Philippines RTA][4] (signed September 2006, not yet effective).[5] Dispute settlement procedures are contained in all the four RTAs, three of which (except Japan-Philippines RTA) are described below.

1) Japan – Singapore RTA

Chapter 21 of the Japan – Singapore RTA provides for general dispute settlement procedures.

The procedures apply to disputes concerning the interpretation or application of the Japan-Singapore RTA and the separate implementing agreement of the RTA [hereinafter Implementing Agreement] (Art 139.1). The Parties retain the right to have recourse to other international dispute settlement procedures, but once any dispute settlement procedure has been initiated with respect to a particular dispute, the other procedures shall not be used for that dispute (Arts 139.2 and 139.3).

Some areas, such as competition and information sharing in securities markets, are fully or partly precluded from application of the procedures set out in Chapter 21 (Arts 105 and 107.3).

Article 140 provides for consultations in order to *avoid* disputes. A Party may request consultations with regard to any matter on the interpretation or application of the RTA and the Implementing Agreement (Art 140.1). If the Parties fail to resolve a matter through consultations, either Party may request a meeting of the Consultative Committee, which consists of representatives of each Party, including one legal expert designated by each Party (Arts 140.3 and 140.4).

When a dispute arises between the Parties,[6] either Party may request consultations with the other Party (Art 142.1). The Parties shall make every effort to reach a mutually satisfactory resolution through consultations (Art 142.3).

If the Parties fail to resolve a dispute through consultations, either Party may request the establishment of an arbitral tribunal (Art 143.1). Three individuals are appointed as arbitrators. One of them shall be appointed by each Party, and the other who chairs the arbitral tribunal shall be selected by agreement of the Parties from a list prepared in advance (Arts 143.3 and 143.4). The tribunal shall make an award in accordance with the RTA, the Implementing Agreement and applicable rules of international law (Art 144.1). The award shall be final and binding, and shall contain findings of law and fact (Arts 144.1(c) and 144.2). The arbitrators may include in the award suggested implementation options for the responding Party (Art 144.1(d)). The award shall be issued within 120 days after the establishment of the tribunal (Art 144.6). The arbitral tribunal shall meet in a closed session, and its deliberations and Parties' submissions shall be kept confidential (Arts 145.1 and 145.2). The arbitral tribunal shall attempt to make its decisions, including its awards, by consensus, while it may also make such decisions by majority vote (Art 144.8).

When the arbitral tribunal finds that the responding Party violates an obligation of the RTA or the Implementing Agreement, the responding Party shall notify the other Party of a reasonable

period of time necessary to resolve the violation (Art 147.1). If the responding Party considers it impracticable to resolve the violation, it shall enter into consultations with the other Party with a view to developing a mutually acceptable resolution through compensation or any alternative arrangement (Art 147.2). If the responding Party fails both to resolve the violation and to offer compensation or any other arrangement, the other Party may suspend the application to the responding Party of its obligations under the RTA or the Implementing Agreement after the completion of necessary procedures (Arts 147.5 to 145.7). Matters arising from the implementation of the award or from suspension may be referred to consultations or an arbitral tribunal (Arts 147.3, 147.4 and 147.8).

At any stage of the above process, good offices, conciliation or mediation may be requested by either Party (Art 141).

Chapter 8, which sets forth rules of investment, provides for special procedures for investment disputes between a Party and an investor of the other Party (Art 82). When an investor of the other Party has incurred loss or damage by reason of, or arising out of, an alleged breach of any right conferred by Chapter 8 with respect to its investments, that investor may request consultations with the Party (Arts 82.1 and 82.2). If the dispute cannot be settled through consultations within five months from the date of the request for consultations, the investor concerned may either (a) request the establishment of an arbitral tribunal in accordance with the procedures set out in Annex Vc of the RTA; (b) submit the dispute to conciliation or arbitration in accordance with the provisions of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States [hereinafter ICSID Convention], or to conciliation or arbitration under the Additional Facility Rules of the International Centre for Settlement of Investment Disputes [hereinafter ICSID Additional Facility Rules]; or (c) submit the dispute to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law [hereinafter UNCITRAL Arbitration Rules] (Art 82.3). The award of the arbitrators shall be final and binding, and shall contain a judgment of whether there has been a breach by the Party and a proposal for remedy if there has been such a breach (Arts 82.10(a) and 82.10(b)). The remedy may be either pecuniary compensation or restitution in kind, or both (Art 82.10(c)).

There have been no disputes so far under the Japan-Singapore RTA.

2) Japan-Mexico RTA

General dispute settlement procedures are set forth in Chapter 15 of the Japan-Mexico RTA. While the basic structure of the procedures is similar to that of the Japan-Singapore RTA, there are some differences between these two as follows.

First of all, there is no dispute *avoidance* provision in the Japan-Mexico RTA.

Second, Article 153.8 defines the terms of reference of an arbitral tribunal. Major differences from the Japan-Singapore RTA that can be drawn from the terms of reference include the following: (a) The arbitral tribunal is required to examine a dispute in light of the relevant provisions of the RTA. This might indicate that rules of international law are not applicable; (b) Where the arbitral tribunal concludes that a measure of a Party is inconsistent with the RTA, the tribunal is required to make recommendations that the Party bring the measure into conformity

with the RTA; (c) The arbitral tribunal is prevented from suggesting specific ways in which the Party could implement the recommendations.

Third, Article 154.6 provides that the arbitral tribunal shall issue an award within a shorter period when a dispute concerns perishable goods.

Fourth, the arbitral tribunal shall take its decisions including its awards by majority vote (Art 154.7).

Fifth, it is explicitly provided that an arbitrator appointed by each Party may be a citizen of each Party (Art 153.4).

Sixth and lastly, the Japan-Mexico RTA exempts a broader range of areas from the application of dispute settlement procedures. The exempted areas include (but are not limited to): competition; sanitary and phytosanitary measures; technical regulations, standards and conformity assessment procedures; financial services (Arts 15, 20, 95, 109, 118, 135, 138 and 148).

Section 2 of Chapter 7 (Arts 75 through 96) provides detailed rules concerning investment disputes between an investor and a Party to the RTA. The procedures are quite similar to those of Article 82 of the Japan-Singapore RTA. One difference is that, in the Japan-Mexico RTA, in case of failure to settle a dispute through consultations, the investor concerned may submit the dispute to any of the following: (a) arbitration under the ICSID Convention; (b) arbitration under the ICSID Additional Facility Rules; (c) arbitration under the UNCITRAL Arbitration Rules; (d) if agreed by the disputing parties, any arbitration in accordance with other arbitration rules (Art 79.1).

No disputes have been brought before the dispute settlement procedures of the Japan – Mexico RTA.

3) Japan-Malaysia RTA

The general dispute settlement procedures set out in Chapter 13 of the Japan-Malaysia RTA are quite similar to those of the Japan-Singapore RTA with some differences.

One of the differences is that there is no dispute *avoidance* provision in the Japan-Malaysia RTA.

Second, the Parties shall enter into consultations within a shorter period after a request for consultations when a dispute concerns perishable goods (Art 146.2).

Third, Article 148.3 explicitly provides that an arbitrator appointed by each Party may be a citizen of each Party.

Fourth, the dispute settlement procedures do not apply to several areas such as competition; sanitary and phytosanitary measures; technical regulations, standards and conformity assessment procedures; improvement of business environment (Arts 67, 72, 133, 138 and 144).

Article 85 sets forth procedures concerning investment disputes between an investor and a Party to the RTA. The procedures are mostly the same as those of the Japan-Singapore RTA. In the Japan-Malaysia RTA, when a dispute cannot be settled through consultations, an investor may submit the dispute to any of the following procedures: (a) the Kuala Lumpur Regional Centre for Arbitration (KLRCA) for settlement by conciliation or arbitration; (b) conciliation or arbitration in accordance with the provisions of the ICSID Convention; (c) arbitration under the UNCITRAL Arbitration Rules; (d) if agreed with the disputing Party, arbitration in accordance with other arbitration rules (Art 85.4).

No disputes have arisen under the Japan-Malaysia RTA.

4) Bilateral Investment Treaties (BITs)

In addition to the above RTAs, Japan has signed 11 BITs, which provide for dispute settlement procedures between an investor and a Party.[7]

3. Who Benefits?

As described above, Japan has signed only four RTAs so far, and there have been no disputes brought before RTA dispute settlement procedures. That said, it has been almost four years since Japan signed its first RTA with Singapore, and trade and investment between the Parties have been expanding. It is not too early to discuss how the dispute settlement procedures of the Japan's RTAs can operate and who can benefit from the procedures.

1) Governments

When a dispute arises in an area that is covered only by an RTA and not by the WTO, the Parties to the RTA have no option but to refer the dispute to the dispute settlement procedures of the RTA (and vice versa). What if a subject of a dispute is covered by both the RTA and the WTO? In some cases, the RTA exempts the subject from the application of its dispute settlement procedures. In other cases, however, both RTA dispute settlement procedures and the WTO dispute settlement system are applicable to the same dispute. Put differently, the Parties have a choice of forum.[8] In such cases, what are the benefits for a government of referring a dispute to RTA dispute settlement procedures instead of referring the same dispute to the WTO dispute settlement system?

First, the period of time to complete the whole process of dispute settlement may be shorter in the RTAs. In the Japan-Singapore RTA, the estimated period of time from a request for consultations to the issuance of an arbitral award is 250 days, whereas in the WTO dispute settlement system, the average time period between panel establishment and the circulation of a final report is 393.47 days.[9] Having said that, it is uncertain whether RTA dispute settlement procedures actually proceed more quickly than the WTO dispute settlement system. On the one

hand, the selection of arbitrators may be quicker than WTO panelist selection because two of the three arbitrators are appointed by the Parties at the discretion of the Parties, and the third arbitrator, in the absence of agreement, is automatically chosen by drawing.[10] On the other hand, a lack of legal support by an independent secretariat may slow the process.

A second possible benefit is that, in RTA dispute settlement procedures, the Parties have broader discretion in choosing arbitrators than in the WTO dispute settlement system. The Parties may choose arbitrators with sufficient knowledge of the legal system of the Parties, the measures at issue and international trade law. This may enhance the credibility of an award of the arbitrators from the standpoint of the responding Party. However if we look at the other side of the coin, decisions made by arbitrators with inside knowledge of the measures at issue may appear to lack objectivity, particularly in the eyes of the complaining Party.

Third, the Parties may resolve a dispute in a more flexible manner in RTA dispute settlement procedures. For example, the Parties may modify the procedural rules by agreement. Moreover, arbitrators may enjoy broader discretion in making decisions given the absence of an appeal procedure. Such flexibility may be preferred, particularly in Asian RTAs. However, it should also be borne in mind that flexibility may lessen the pressure on the responding Party to comply with an arbitral award. In addition, lack of coherence might undermine the credibility of an award.

To conclude, while there are potential benefits to governments of using RTA dispute settlement procedures, how the procedures actually operate is quite uncertain. Moreover, the effectiveness of RTA dispute settlement procedures may be affected by a wider range of factors than the WTO dispute settlement system, such as the quality of arbitrators and their awards, political and/or economic relations of the Parties, and so on. Given these circumstances, governments may prefer to bring a dispute to the WTO dispute settlement system, which has already achieved solid success. This conclusion can be reinforced by the fact that state-state dispute settlement procedures in other RTAs are not so frequently used.

Then the question is why governments (including the Japanese government) include state-to-state dispute settlement provisions in RTAs. There are some possible answers to this question. First, the existence of dispute settlement procedures can promote future compliance with an RTA even if the procedures are not actually used. Second, the inclusion of dispute settlement procedures can demonstrate a serious commitment of governments to an RTA. Third, the success of the WTO dispute settlement system may have motivated RTA negotiators to establish dispute settlement procedures.

It is likely that the state-to-state dispute settlement procedures of Japan's RTAs will remain supplementary to the WTO dispute settlement system in the foreseeable future. Do we want to activate RTA state-to-state dispute settlement procedures? If so, businesses and citizens may hold the key.

2) Businesses

Do businesses benefit from having dispute settlement procedures in RTAs?

The most obvious benefit to businesses of having RTA dispute settlement procedures is that RTAs often include investor-state dispute settlement procedures. Under Japan's RTAs, like most other RTAs, an investor of the Party may request consultations with a government of the other Party with respect to its investments, and if the investor cannot achieve a satisfactory resolution through consultations, it may submit the dispute to arbitration.[11] Investor-state dispute settlement procedures are beneficial to businesses for several reasons. First, businesses can bypass the domestic courts of the other Party that may lack experience and expertise in dealing with transnational investment disputes. Second, direct standing to bring a claim may help businesses avoid the so-called agency problem. Third, remedies such as monetary damages are directly available to investors. Fourth, as a result of the above factors, businesses can enjoy a more predictable environment for their foreign investments.

Japanese companies have not been active in using investor-state dispute settlement procedures so far. According to a survey by the Nippon Keidanren, 50% of the Japanese companies surveyed believe that the WTO dispute settlement system should be prioritized, while the other 50% are positive towards the inclusion of investor-state dispute settlement procedures.[12] Reasons for the negative attitude include: time and financial costs of arbitration directly borne by investors; cultural background; investors' lack of knowledge and experience. However, the situation may change as Japanese companies increase their foreign investments. Moreover, the recent increasing use of investment arbitration worldwide may spur Japanese companies to think seriously about using this option. It is quite possible that investor-state dispute settlement procedures will play an essential role in Japan's RTAs in the near future.[13]

Two additional innovations to enhance the participation of businesses in RTA dispute settlement procedures merit consideration. First, it is desirable to establish special procedures to settle a trade remedy dispute between an exporter and an importing economy. Most economies, including Japan, do not have a special international trade court, and trade cases including trade remedy cases are handled by ordinary courts that may lack knowledge and experience in international trade cases. RTA special procedures, as an alternative to domestic courts, may be able to settle trade remedy cases more effectively and objectively than domestic courts. Moreover, RTA special procedures are also preferable to the WTO dispute settlement system in terms of: time and financial costs; flexibility; depoliticization of disputes.

Second, it may be useful to allow businesses to make submissions to arbitrators not only in investment disputes but also in other disputes.[14] Unlike WTO panels and the Appellate Body, RTA arbitrators enjoy a certain degree of flexibility in adjudicating disputes and probably have an understanding of the background to the measures at issue. In addition, unlike WTO Members, Parties to RTAs often share common values on trade and non-trade issues. Given these circumstances, input from businesses may help arbitrators strike a balance between competing interests and find a proper solution to a dispute.[15]

3) Citizens

Do RTA dispute settlement procedures bring any benefits to citizens?

At this moment, Japan's RTAs do not open the door for citizens to participate in RTA dispute settlement procedures. The RTA dispute settlement procedures may appear remote from citizens'

interests. However, as the WTO experience reveals, citizens are becoming more and more interested in international trade disputes, and the settlement of such disputes in the absence of citizens is being increasingly perceived as illegitimate. The legitimacy crisis becomes even more severe in investment arbitration in which a private business entity may succeed in striking down a public policy measure of the host economy.[16]

One possible way to alleviate the crisis is to allow the participation of citizens in RTA dispute settlement procedures. The participation of citizens is particularly useful in RTA investment arbitration. Submissions by citizens can assist arbitrators in resolving investment disputes considering not only the economic interest of a disputing investor but also the broader public interests of citizens. Citizens' submissions may also be beneficial in RTA state-to-state dispute settlement procedures. As pointed out above, RTA state-to-state dispute settlement procedures are superior to the WTO dispute settlement system in terms of: flexibility of the procedures; arbitrators' understanding of the measures at issue; Parties' shared common values. These advantages put RTA arbitrators in a better position to balance competing interests. Moreover, various problems associated with citizens' participation *in the WTO dispute settlement system*, such as geographical distance from the forum and capacity gaps among citizens, may be reduced in RTA dispute settlement procedures. RTA state-to-state dispute settlement procedures may be able to take on a new role by allowing the participation of citizens.

4. Concluding Remarks

This paper described dispute settlement procedures of the RTAs signed by Japan and analyzed who can benefit from these procedures. The major conclusions of the study are summarized below.

First, for governments, it is uncertain whether they can obtain any benefits from referring a dispute to RTA dispute settlement procedures instead of the WTO dispute settlement system. Most of the time, the WTO dispute settlement system may be preferable for them. Second, businesses can expect to benefit from RTA investor-state dispute settlement procedures. Third, RTA dispute settlement procedures are potentially superior to the WTO dispute settlement system in some respects, and they may play a unique role in the future by enhancing the participation of businesses and citizens.

[1] Agreement between Japan and Singapore for a New-Age Economic Partnership, WT/REG140/1 (3 Dec. 2002).
[2] Economic Partnership Agreement between Japan and Mexico, WT/REG198/1 (9 May 2005).
[3] The text is available at the website of the Ministry of Foreign Affairs (MOFA) of Japan, http://www.mofa.go.jp/region/asia-paci/malaysia/agreement/index.html (last visited 13 Sept 2006).
[4] The text in Japanese is available at the website of the MOFA of Japan, http://www.mofa.go.jp/mofaj/gaiko/fta/j_asean/philippines/jyobun.html (last visited 13 Sept. 2006).
[5] Japan is also in RTA negotiations with Korea, Indonesia, Thailand, Viet Nam, Chile and the ASEAN as a whole.
[6] A dispute arises when any benefit accruing to a Party directly or indirectly by the RTA or the Implementing Agreement is being nullified or impaired as a result of act or failure to act inconsistent with the RTA or the Implementing Agreement (Art 142.1).
[7] Japan has signed BITs with the followings: Egypt, Sri Lanka, China, Turkey, Hong Kong, China, Pakistan, Bangladesh, the Russian Federation, Mongolia, Korea and Viet Nam.
[8] In the Japan-Philippines RTA, the Parties shall give priority consideration to the use of the WTO dispute settlement system when a subject of a dispute is covered by both the WTO dispute settlement system and the RTA dispute settlement procedures (Art 149.5).
[9] WorldTradeLaw.net, Timing of Establishment, Composition, Issuance and Circulation of WTO Panel Reports, http://www.worldtradelaw.net/dsc/database/paneltiming.asp (last visited 13 Sept. 2006).
[10] Japan-Singapore RTA, Art 143.4(d); Japan-Mexico RTA, Art 153.6; Japan-Philippines RTA, Art 153.5. In the Japan-Malaysia RTA, third arbitrator, if not agreed by the Parties, may be appointed the Director-General of the WTO (Art 148.4).
[11] The Japan-Philippines RTA does not contain investor-state dispute settlement procedures. It provides that the Parties shall commence additional negotiations to establish investor-state dispute settlement procedures after the RTA comes into effect (Art 107.1).
[12] Nippon Keidanren (Japan Business Federation), Toward for the Creation of International Investment Rules and Improvement of the Japanese Investment Environment, Annex 3: Outline of Results of Investment Questionnaire, http://www.keidanren.or.jp/english/policy/2002/042/annex3.html (last visited 13 Sept. 2006).
[13] *Cf*. Robert Anderson, *Nomura gains upper hand in battle over IPB: The Japanese bank has won one round in its tussle with Czechs*, FIN. TIMES, 25 Apr. 2006, at 30. *But see* Australia-United States Free Trade Agreement, US-Austl., 18 May 2004, 118 Stat. 919, *available at* http://www.dfat.gov.au/trade/negotiations/us_fta/final-text/index.html (last visited 13 Sept. 2006).
[14] *Cf*. The Japan-Malaysia RTA provides that each government shall endeavor to provide a reasonable opportunity for comments by the public and give consideration to those comments before adoption of regulations of general application that affect any matter covered by the RTA (Art 4(b)). *See also* Japan-Philippines RTA, Art 5.
[15] The author has a negative view on the direct participation of private parties (including businesses and citizens) *in the WTO dispute settlement system*.
[16] *Cf*. Ethyl Corp. v. Canada (Award on Jurisdiction), NAFTA Ch. 11 Arb. Trib., (1998), 38 I.L.M. 708 (1999).

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East Asian Community: Myth or Reality [1]

Written by

Rajesh Sharma

Associate Director, Hong Kong WTO Research Institute
Assistant Professor, Faculty of Law, Macau University of Science and Technology

The first East Asian Summit (EAS) held in Malaysia in 2005 has generated a great deal of discussion about the possibility of creating the East Asian Community (EAC).[2] The EAC, if created, may create a "third pole" of economies and it will provide the "arch of advantage" considering the 21st Century as the "Asian Century".[3] The EAC, as envisaged, will not be a "caucus without Caucasian" but it will include Australia and New Zealand under its umbrella of Pan Asia. [4]

The hype generated by the possibility of creating the EAC raises few fundamental questions. The very first question to be asked, why do we need a community for Asia? If we do need a community then who could or should be included in the Community? What should be the real aim and objective of this EAC? Should the EAC be another regional group or should it have some other functions too? What negotiation strategies should be adopted to create the EAC? What would be the effect of the EAC on the Socio-political and the economic situation of the member economies as well as the world economy?

1. The Need

Asia being the "engine of growth" of the world economy has prompted it to take a bigger role in the world affairs, more importantly to create a unified voice at least in the world economic affairs.[5] Individual economies from Asia, except for a few, may not create any impact on the world level but the concerted and collective efforts of the Asian economies may create a profound impact. The first collective move under the banner of the EAS has seen the movement in the European Community which eyeing to get an observer status in the EAS or later in the EAC.[6] Moreover, other continents have their own sort of groupings to put forward their own

collective interest to the world but Asia as such does not have any forum or groupings. From the perspective of generating one "Asian voice", the creation of the EAC would be beneficial for Asia.

If we look at Asia, there are different groups such as Association of Southeast Asian Nations (ASEAN) and South Asian Association for Regional Cooperation (SAARC) which are promoting their collective interests but they are not effective enough for various reasons. The main reasons being the economic disparities among member economies and the leading Asian economies are not included as members. ASEAN without China, India, Japan and Korea cannot provide an "Asian voice" and SAARC, with India as the only leading economies cannot call itself the "Asian voice" either.[7] Asia-Pacific Economic Cooperation (APEC) is another strong forum which has many leading Asian economies as its members (excluding India) but it cannot represent "Asian voice" for the very fact that it also includes major non-Asian economies as members. In absence of any forum where all major economies of Asia can join together, the idea of creating the EAC seems to be the need of Asia.

ASEAN, ASEAN + 3 (China, Japan and Korea) and ASEAN + 1 (India) together bring all major Asian economies together. For this reason alone, ASEAN may serve as the nucleus of the EAC. ASEAN has its own plan to establish its own ASEAN community by 2015 irrespective of the fact whether the EAC is created or not. This parallel process is good if it can lead to the formation of the EAC. Otherwise, ASAEN community may itself pose possible rivalry among Asian economies because the main aim of the ASEAN community is to counter the rising economic growth of China and India. With this view in heart, ASEAN alone can hardly represent Asia at the global level. In the EAS, members agreed to meet and discuss about the EAC on the occasion of annual ASEAN summit where all major Asian economies, which have potential to create the EAC, meet.[8] This will allow members to change the track when the time is ripe to go forward with the creation of the EAC.

2. Membership and Leadership

At the very conception of the EAS the issue of membership and leadership has posed challenge.[9] It is not just a matter of definitional issue but it is a matter of exercising political and economic powers in the region. The invitation of Australia and New Zealand to join the EAS was more of definitional issue as to whether "Asia" includes Australia and New Zealand. Asia as a continent certainly does not include Australia and New Zealand but due to geographical reasons for creating a community like the EAC, these two economies will have legitimate interest.[10] If we adopt the idea of Pan Asia then it would be easy to include Australia and New Zealand with the EAC. One may argue that the EAC may be created even without inclusion of Australia and New Zealand and the true EAC should be with "Asian Face" only.[11] Such approach, however, will undermine the effectiveness of the EAC as a collective voice at the world stage. As a Pan Asian forum (with inclusion of Australia and New Zealand), the idea of the EAC will not be diluted. The example of Turkey which is in the process of joining the European Union is the case on point. However, if the definition or coverage of Pan Asia extends over the Pacific (like APEC) then the idea of the EAC will certainly be diluted and it will loose all its essence. If for some reasons economies at the Pacific coast needs to be included in the EAC then there is no need to create the EAC because then APEC, with some variations, may

serve the same purpose.

From geographical and definitional perspective the membership of the Russian Federation poses even greater challenge. If the EAC is supposed to be the voice of Asia then the Russian Federation should be included for the simple reason based on its geographical location. On the other hand if the EAC is going to represent only the East and the South Asian economies then the Russian Federation will be out of the loop. Hence the definition of the Asia or Pan Asia will be crucial for the formation of the EAC. At least, the geographical boundaries of the EAC have to be determined. At this moment the Russian Federation has been kept out of the initial core membership of the EAC but in future the issue will crop up again.[12]

The membership issue of South Asian economies is more controversial and questionable than the membership of non-Asian economies like Australia and New Zealand. From South Asia, India is the only economy which is part of the EAC team. The recent economic growth of India and closer engagement with ASEAN has been crucial for the inclusion of India in the EAC discussion.[13] Some may also argue that the inclusion of India was motivated by the political concerns. Politics has its own role to play but the hard fact for India is her economic prowess, which makes her indispensable in any discussion at Asian level as well as at global level. As thing stands now, the EAC without India is hard to imagine because it cannot represent Asian voice. Similarly, China, Japan and Korea cannot be ignored at any cost for creation of a true EAC.

India, with the opening of its economy, also adopted "look east" policy which was not only "a strategic shift in India's vision of the world and India's place in the evolving global economy" but also an external economic policy.[14] At that time India was not an economic giant, nevertheless, it was realized by the policymakers that the economic growth of India is closely linked with the growth of her Asian neighbors in the East. The result of such strategy has paid off for India. The economic relationship has been fortified with Asian economies particularly with Singapore.[15] While pursuing her "look east" policy, India also took initiative at the global stage to protect the interest of Asian economies particularly of the developing and weak economies. WTO is the main forum where India raised the concerns of developing economies which were also the main cause of concerns for her East Asian partners. WTO forum provided India to closely connect with other East Asian as well as the South Asian economies at a different level and across the boundary of geo-politics of the region.

One of the plausible reasons for India to engage with ASEAN was to plug into APEC when the moratorium for the membership will be lifted for APEC. Majority of the ASEAN members are also members of APEC hence it was a good opportunity for India to tie up with ASEAN. The first mover advantage for India from the South Asia region in ASEAN was also motivated by some political intent mainly to keep Pakistan out of ASEAN and possibly from APEC too. Over the period, the political motive has gone to the back stage and the economic issues have taken the centre stage for India. Now, engagement of India with ASEAN and the EAC is more for economic reasons than the political one. However, one cannot ignore politics from trade which has surfaced at the initial stage of the EAC.

The membership issue of the EAC from the political and economic perspectives will pose a challenge in future when Bangladesh, Pakistan and Sri Lanka will pursue the membership at the EAS and eventually for the EAC. In the coming years, these economies will grow economically and will have legitimate interest to join the EAC. At that moment, political concerns of India

will not be able to dictate the membership of Bangladesh, Pakistan and Sri Lanka. As a matter of principle, the membership of the EAC must not be governed by politics alone and economic factor should be the prime considerations. India and Pakistan have already proven this fact in the WTO that despite political problems, both economies may work together for common economic interest. Therefore, when Pakistan is included as the member of the EAS or the EAC, India can work together for the economic prosperity of the EAC. Similarly, other member economies of the EAC may also try to adopt such approach towards existing as well as new members.

In the first EAS, it was obvious that there was some kind of struggle between economies to take leadership for the EAC.[16] ASEAN as whole, particularly Malaysia was not interested in handing over the leadership to any one economy. Singapore on the other hand was advocating that both China and India have to take collective leadership.[17] This however, reflects the contrary to the aim of ASEAN which is currently working hard to create its own community to ward off the economic impact of China and India. Japan has proposed the idea of Comprehensive Economic Partnership Arrangement in East Asia to enter into a Free Trade Agreement among 16 economies (ASEAN-10, Australia, China, India, Japan, Korea and New Zealand) which is the reflection of the EAC but it has not explicitly announced to be interested in taking up the leadership for the EAC or Pan Asia.[18] Korea similarly has been quiet on this issue. Only thing which was clear during the first EAS was that which economy does not want who to take the leadership role. Ultimately, it was agreed that for the time being ASAEN will take the central role of collective leadership for the EAS and the EAC.[19] It was also agreed that criteria of participation will be based on the criteria established by ASEAN.[20] More importantly, for two years there will be a moratorium on the membership so that the core members will get some time to work out the modalities of the EAS and eventually for the EAC.

3. The Ultimate Aim

The formation of EAC cannot be based only on economics and trade. The EAC needs to consider other factors too considering the different development stages of economies in this region. The economic disparities among economies coupled with the large population, poverty, poor health, low level of education and inadequate infrastructure make this region unique. Unique in the sense that mere lowering down the tariff for trade will not solve the root problems of this region. The people of this region will not be supportive of any such move of their government unless the fruit of development passes on the lower strata of the society in an economy and the region on the whole. The EAC has to show the development within the whole region and to show “development with human face”.[21]

In the first EAS, member economies agreed that the aim should be to eradicate poverty, and narrowing down the development gap in East Asia through technology transfer and infrastructure development, capacity building, good governance and humanitarian assistance. In addition, it was also agreed that people-to-people contact and enhanced cooperation in uplifting lives and well being of people will be the focus of the EAS.[22]

The aim of free and liberalized trade cannot be achieved unless the whole region is linked by road, rail, ports, waterways and airways. In absence of any road intra- regional movements of

goods will not be feasible at a cheaper price. A major part of this region is not connected by cheaper mode of transportation such as road, rail and waterways. Although it is the prime intent of economies in this region however due to lack of economic resources or lack of availability of professional human resources and capacity, it is hard for those economies to build proper infrastructure for trade. Therefore, other comparatively developed economies have to shoulder the responsibility to developing these infrastructures through various modes of investment. For the successful EAC, economies have to join together to help each other in building the community. India, during the first EAS, proposed several measures mainly relating to development of human resources through education and professional training and capacity building, transfer of technology including providing IT support and road and rail projects in the neighboring economies. At the same time, India also invited Japan and others to invest in the areas of infrastructure like ports and roads connecting to ports around India and airports. India alone can offer investment opportunities for the next 10 years.[23]

It is very important for policy makers and leaders to take a top down as well as a bottom-up approach in community building in the East Asia so that creation of wealth and equitable distribution of wealth must happen at the same time so that people at a larger level could receive the benefits of the development in order to appreciate and support the creation of the EAC.[24]

4. Negotiation Strategies

The negotiation for the EAC may be carried out at two levels. The first level is, the negotiation which are relating to formation of the EAC such as membership, definition, geographical boundaries etc. Such issues of negotiations are more of a political negotiation. The second level of negotiation is relating to the specific issues within the EAC such as tariffs, investment, etc. Having agreed to keep ASEAN in the core, the negotiation for the EAC has several options such as ASAEN+3, or ASAEN+1, or all member economies of the EAS negotiate together. At present there is no clear indication as to how the negotiation will proceed. It has been agreed that the EAS will be conducted back to back with ASEAN annual meeting[25] so there is a view that negotiation for the EAC will be between ASEAN at one side and all other member economies (such as China, India Japan and Korea) together on the other side.[26] Thus the mode of negotiation will be like ASEAN+1 process. In this way, there will be no need to adopt a ASAEN+3 processes. However, the possibility of having negotiation between all member economies should not be ruled out.

For the negotiation of the specific issues, the traditional mode of negotiation may be cumbersome. For example, the positive list or the negative list approach may not work out. For example, India in its meeting with ASEAN produced a long negative list of sensitive products which left no room for further negotiation. Similarly, if most of the member economies will produce such long negative list then the aim of liberalization of trade will not be accomplished.

Another limitation to the list based negotiation is that each participating economies try to match number and items on the list. For example, if an economy gives 273 items a zero duty access to its market then in return that economy would also like to receive the same number of items to be given a zero duty access in the other economy irrespective of the fact that some of the items may not generate any economic benefits. It has also been seen that if an economy gives duty

free access of a mineral product or an agricultural product then that economy would also like to have the same treatment for its own mineral product and agricultural product in the other economy. List based approach of negotiation has now become a haggling issue which often does not generate good outcome. Therefore, a new approach may be devised for negotiations in the EAC. Even if a list based approached is adopted then there should not be any need to match number of items or nature of products. Those products which may give more economic benefits in practical terms should be considered.

Another new way of negotiating specific issues may be on a "project-by-project basis". For example, if road works have been agreed to work upon then each and every item of hardware and software related to that road project may be negotiated and agreed. In other words, road projects may need capital, labor and professional resources. So the parties may agree to provide free movement of capital, movement of labor and movement professionals relating to road projects. Once the project finishes then the preferential treatment may be withdrawn and situation will revert back to its original position if the situation demands so or else the improved situation may remain active. In that case, an infrastructure will be established and other related issues such as movement of people and capital may be liberalized only for that project rather than the whole economy. We have such examples to follow and adopt. In the WTO, under Agreement on Information Technology Products, information technology (IT) related products were given duty free access. At that time, IT became the most important sector for development and economies agreed to such arrangements. Within the EAC, such approach to negotiation may be adopted and that will suit the needs of the member economies.

5. Conclusion

It is no exaggeration to say that the Asia region is the engine of the world economy. No matter whether the EAC comes into fruition or not the Asian region will provide dynamism to the world in this century. However, in order to make the Asian voice heard, Asia needs a platform and the EAC will be able to provide such platform. The EAC will also provide a forum where all the Asian economies could gather together because at this moment there is no such forum in Asia. The EAC will also streamline the various regional trade agreements which are currently being negotiated among Asian economies or with non-Asian economies.

The probable challenges for the EAC are the membership and leadership issues. The membership includes the issues relating to the definition and geographical boundaries of the EAC. No matter what would be the definition and geographical boundaries, there should be ways for other Asian economies to join the EAC. The membership criteria must not be based on politics but it should be based on economic factors. In addition to membership and leadership issue, another definitional issue that is the definition of Asia or Asian may pose even greater challenge.

In order to create the EAC the negotiation must be conducted at two levels. The first, on a political level, is to decide upon the modalities, membership and geographical boundaries of the EAC. The second level of negotiation should be on a more specific issue of tariff, investment and services etc. In order to achieve the prime objectives the negotiation strategies must adopt some new approach rather than sticking to the traditional list based negotiation. For that purpose,

a project-by-project approach of negotiation may be adopted.

For the success of the EAC, the benefits of the development must trickle down to the lower level of the society and it must flow over all the economies within the EAC. The EAC must not only be a community with "Asian face" but it must also show "development with human face".

[1] The views presented here are of author only and they do not represent the views of any institute or organization.
[2] During the first East Asian Summit a protocol was also signed on 14 December 2005 named as "Kuala Lumpur Declaration". The document was signed by all ASAEN members together with China, Japan, Korea and India. The text of the Declaration is available at http://www.aseansec.org. In the Declaration an idea of community building was mooted. In this article the EAS and the EAC has been used interchangeably.
[3] Speech of Prime Minister of India, Dr Manmohan Singh at the Third India-ASAEN Business Sumit, 19 October 2004, New Delhi. The text of the speech is available at http://pmindia.nic.in/speech
[4] The then Prime Minster of Malaysia Dr Mahathir Mohamad, in 1991, first proposed the East Asian Economic Caucus which was called a caucus without Caucasians because US was not part of it and membership criteria was too narrow only to include Asian countries. See Mohan Malik, The East Asia Summit: More Discord than Accord, *Yale Global Online*, http://yaleglobal.yale.edu
[5] Termsak Chalermpalnupap, "Towards an East Asian Community: The Journey Has Begun", http://www.aseansec.org
[6] "East Asian Summit Freezes Membership", New Asia Monitor, July 2006.
[7] ASAEN has engaged China, Japan and Korea under ASEAN + 3 process.
[8] See the Kula Lumpur Declaration.
[9] See Mohan Malik, supra.
[10] Japan's Minister for Foreign Affairs Mr. Taro Aso is of the view that India, Australia and New Zealand together with ASEAN and China, Japan, Korea will play a crucial role in connecting Asia.
[11] Nagesh Kumar, Towards an East Asian Economic Unit, *New Asia Monitor*, July 2006.
[12] "East Asia Summit Freezes Membership", New Asia Monitor, July 2006.
[13] India has been engaged with ASEAN under ASAEN+1 process.
[14] See Indian Prime Minister's keynote address at special leaders dialogue of ASEAN Business Advisory Council, Kuala Lumpur , 12 December 2006, http://pmindia.nic.in/speeches
[15] India signed a Comprehensive Economic Cooperation Agreement with Singapore in 2005.
[16] See Mohan Malik, supra.
[17] Lee Hsein Loong, The Future of East Asian Co-operation, speech delivered at the 11th International Conference on the Future of Asia on 25 May 2005, Tokyo, Japan. The text of the speech is available at http://www.aseansec.org
[18] The Japanese Economy, Trade and Industry Minister, Toshihiro Nikai made this proposal in August 2006 with a view to make Asia as "high quality economic block". The Nikai proposal also proposed to establish an OECD like think tank to assist the process of regional integration. See Japan Looks to Play leading Role in Regional Trade, *Daily Yomiuri*, Japan, 15 September 2006
[19] See Kuala Lumpur Declaration.
[20] The three criteria which are imposed by ASEAN are that the economy must already be a dialogue partner of ASEAN, the second, the economy must subscribe to ASEAN's non-aggression treaty and thirdly, the economy must have substantive relations with the grouping. See "East Asia Summit Freezes Membership" supra.
[21] Prime Minister of India Dr Manmohan Singh has given the slogan of "Development with Human Face".
[22] See Kuala Lumpur Declaration.
[23] In India, air ports and railway needs US$55 billion for development in ten ears time, power sector needs US$75 billion, telecom sector needs US$25 billion in five years time. T total of US$150 billion may be absorbed by India in the next 10 years. See Indian Prime Minister Address at the Third India-ASEAN Business Summit, 19 October 2004, New Delhi.
[24] The World Economic Forum suggested that East Asia should pursue "bottom-up". See World Economic Forum Discusses East Asian Growth and Integration, *New Asia Monitor*, July 2006.
[25] See Kuala Lumpur Declaration
[26] S. Puspanathan, East Asian Summit: Keeping the momentum going, *The Strait Times*, 29 December 2005.