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A Case for a Single East Asian FTA

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# Regionalism as an Engine of Multilateralism: A Case for a Single East Asian FTA

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## *Abstract:*

As East Asia becomes increasingly integrated through market-driven trade and FDI activities, free trade agreements (FTAs) are proliferating. Consolidation of multiple and overlapping FTAs into a single East Asian FTA can help mitigate the harmful noodle bowl effects of different or competing tariffs, standards, and rules. A region-wide FTA will also encourage participation of low-income countries and reduce trade-related business costs, particularly for small and medium enterprises. A computable general equilibrium (CGE) model examines the economic impact of various types of FTAs in East Asia (among ASEAN+1's, ASEAN+3, and ASEAN+6) finding that consolidation at the ASEAN+6 level would yield the largest gains to East Asia among plausible regional trade arrangements.

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## I. Introduction: Key Issues

East Asian economies have grown rapidly over the last four decades, driven by the expansion of international trade and foreign direct investment (FDI). They now have moved toward formal economic integration through bilateral and plurilateral free trade agreements (FTAs). The Association of Southeast Asian Nations (ASEAN) is emerging as the integration hub for FTAs in East Asia, while the People's Republic of China (PRC), Japan, and Republic of Korea (Korea) also have formal economic ties with ASEAN. India, Australia, and New Zealand are also joining the bandwagon. How can East Asia ensure this noodle bowl of FTAs can be consolidated into a single East Asian FTA—a stepping stone toward global integration?<sup>1</sup>

This paper analyzes this question and its ramifications. Section 2 highlights the progress of market-driven regional economic integration in East Asia through trade and FDI. Section 3 summarizes some salient characteristics of East Asian FTAs. Section 4 tackles policy issues for helping multilateralize East Asian FTAs at the regional level so as to become a stepping stone, rather than a stumbling block, to global economic integration. And Section 5 concludes by focusing on how East Asia should strengthen trade and FDI ties with North America and Europe. Appendix 1 examines the economic impact of various types of FTAs in East Asia (among ASEAN+1's, ASEAN+3, and ASEAN+6)<sup>2</sup> using a computable general equilibrium (CGE) model.

## II. Economic Integration and FTA Initiatives in East Asia

### A. Market-Driven Economic Integration in East Asia

**Economic integration through trade and FDI:** East Asia has long enjoyed a market-driven expansion of trade and FDI. The region's exports rose from 14% of total world exports in 1980 to 27% in 2006, while its imports expanded from 15% to 24% during 1980–2006.<sup>3</sup> FDI inflows into East Asia (including Japan) more than tripled from 5% of the world total in 1980 to 14% in 2006, while East Asian FDI outflows increased from 5% to 11% of the world total over the same period. This has been accompanied by rising intra-regional concentration of trade and FDI activities.

Table 1 summarizes changes in the share of intra-regional trade for various groupings in the world over 1980–2006. It shows that intra-regional trade as a share of East Asia's total trade including Japan rose from 37% in 1980 to 55% in 2006 or from 23% to 46% over the same period if Japan is excluded. Intra-regional trade within East Asia remains below that of the European Union-15 (which peaked at 66% in 1990), but exceeds that of the North American Free Trade Area (which peaked at 49% in 2001).

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<sup>1</sup> For pioneering work on noodle bowls as building blocs on the path to global free trade and a possible new role for the WTO see Baldwin (2006 and 2007).

<sup>2</sup> ASEAN includes Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam. ASEAN+3 includes the 10 ASEAN members plus PRC, Japan, and Korea; ASEAN+6 is ASEAN+3 plus Australia, India, and New Zealand.

<sup>3</sup> Here, East Asia includes the 10 ASEAN countries plus PRC; Hong Kong, China; Japan; Korea; and Taipei, China.

FDI inflows into emerging East Asia have contributed to regional economic integration. Table 2 summarizes the source regions/economies of emerging East Asian FDI inflows (cumulative figures) for 1995–2005. Firms from major industrialized countries as well as those from within emerging East Asia are the main investors. Indeed, multinational corporations from the European Union (EU), the United States (US), and Japan account for 15%, 14%, and 11%, respectively, of cumulative FDI inflows over the period. More specifically, the largest investors in Asia's newly industrializing economies (NIEs), particularly Singapore and Taipei, China, come from the US. In contrast, the EU is the largest developed investor in ASEAN-9 (which excludes Singapore), particularly in Indonesia and Viet Nam, while Japan is the largest developed country investor in Thailand. However, in Thailand and Viet Nam, the Asian NIEs are the most dominant investors. In the case of the PRC, Hong Kong, China is by far the largest investor.<sup>4</sup> Notable is the rising importance of FDI from the Asian NIEs, which account for 29% of total FDI inflows to ASEAN-9 and 54% of total inflows to the PRC. More recently, firms from middle-income ASEAN countries, such as Malaysia and Thailand, have also begun to invest in other ASEAN countries and the PRC. Emerging East Asia itself—in addition to the EU, US, and Japan—has become a very important foreign direct investor in emerging East Asia.<sup>5</sup>

**Factors behind trade and FDI integration:** There are several factors behind the expansion of trade and FDI and the resulting economic integration of East Asian economies. First, these economies have pursued trade and investment liberalization as part of outward-oriented trade and FDI policies within the multilateral framework under the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO) and open regionalism through Asia-Pacific Economic Cooperation (APEC). A key feature is that the region has avoided discriminatory trade practices and has adopted complementary domestic reforms.

Second, through FDI, global multinational corporations and later local East Asian firms have formed production networks and supply chains throughout East Asia. This has promoted the dynamic evolution of intra-regional division of labor and led to the rise of vertical intra-industry trade in parts, components, and semifinished and finished manufactured products.<sup>6</sup> The large FDI inflows have stimulated the region's use of trade in a way that reflects the individual economies' stages of industrial development. The Asian NIEs were the first to join such networks, followed by middle-income ASEAN countries, and later by the PRC and Viet Nam.

Third, improved physical and digital infrastructure investment have reduced trade and logistics costs and thus encouraged trade and investment. This has helped the emergence of clusters of manufacturing firms and supplier networks within East Asia.

Fourth, rapid growth of the largest emerging market economy, the PRC, has contributed to closer economic ties within East Asia. The PRC now plays a major role in production networks and supply chains because its expanding exports require intermediate product imports from neighbors. India's robust economic growth is also expected to strengthen regional economic links.

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<sup>4</sup> The large volume of Hong Kong, China FDI flows to the PRC may contain "round tripping" from the PRC, which aims to take tax and other advantages provided to "foreign" direct investment.

<sup>5</sup> If data for the early 1990s and 1980s are included, Japan is seen as a major investor in ASEAN.

<sup>6</sup> See Kawai (1997, 2005b), Kawai and Urata (1998, 2004), Urata (2001), Athukorala (2003), and Fukao, Ishido, and Ito (2003).

All of these factors have led to East Asia's greater economic openness and globalization, which in turn has created natural (*de facto*) regional concentration of trade and FDI activities in East Asia. North America and Europe remain important markets for East Asia's finished manufactured products but, with the growth of regional markets, the relative importance of these outside markets has been declining over time.

## **B. FTA Initiatives in East Asia**

**Proliferation of FTAs:** East Asia is a latecomer in the move toward FTAs compared with the Americas, Europe, and Africa, but has seen an unprecedented increase in total FTA activity since the 1990s.<sup>7</sup> Multilateralism through the WTO framework and open regionalism centered on APEC were the bedrock of the region's approach to international trade for several decades. Recently, many governments in East Asia have entered bilateral and plurilateral trade arrangements. Notably, Japan implemented bilateral economic partnership agreements (EPAs) with Singapore, Mexico, Malaysia, Chile, and Thailand; signed EPAs with the Philippines, Brunei Darussalam, and Indonesia; has reached an agreement in principle with ASEAN; and is negotiating agreements with Korea, Viet Nam, India, and Australia.<sup>8</sup> The PRC implemented an FTA on goods with ASEAN and is now negotiating agreements on services and investment. Korea has also implemented an FTA with Chile and an FTA on goods with ASEAN and has reached an agreement on an FTA with the US. ASEAN is even more aggressive: while enacting FTAs with the PRC and Korea, ASEAN is negotiating with Australia-New Zealand and India, and considering negotiating with the EU. Some ASEAN members, such as Singapore and Thailand, are actively pursuing bilateral FTAs. Amid this bandwagon effect among the East Asian economies, Australia, New Zealand, and India have also joined in. The liberalization schedules among East Asian economies show measures fully implemented by 2020 (Table 3).

The PRC has proposed a Northeast Asian FTA among the PRC, Japan, and Korea,<sup>9</sup> as well as an East Asia-wide FTA for ASEAN+3. Japan has also proposed an even bigger regional EPA for ASEAN+6 countries (ASEAN+3 plus Australia, New Zealand, and India), called a Comprehensive Economic Partnership in East Asia. Official studies have been conducted or initiated on the feasibility and desirability of these two East Asian FTAs. However, no negotiation schedule has been proposed.

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<sup>7</sup> According to Estevadeordal, Shearer, and Suominen (2007), the first FTAs in Latin America and the Caribbean were several intra-regional customs unions (for example, the Andean Community, Central American Common Market, the Caribbean Community and Southern Common Market) formed in the early 1990s. There has been a notable increase in agreements and three dozen intra-regional and extra-regional FTAs had been to the WTO by 2006.

<sup>8</sup> The Japanese government promotes economic partnership agreements (EPAs) that include, but go beyond, elements of FTAs (elimination/reduction of tariffs and liberalization of services trade). Essentially EPAs (i) ensure free movement of goods, services, and people (mutual abolition of tariffs; development of logistics systems, infrastructure, and simpler customs clearance; services deregulation; and movement of skilled temporary workers and provision of training programs); (ii) facilitate intraregional economic activities (standardization of investment rules and dispute settlements; and harmonization of intellectual property systems, certification systems, and competition laws); and (iii) economic cooperation (economic/social infrastructure and cooperation in human resource development, industrial policy, environment, and energy conservation).

<sup>9</sup> Japan is cautious about such an arrangement with the PRC at this point. Its official view is that before negotiating an FTA/EPA, the PRC must clearly demonstrate compliance with all the commitments made in WTO accession negotiations.

For Northeast Asian economies, these FTA initiatives shift away from a long-standing policy of pursuing trade liberalization only through multilateral frameworks based on the WTO and APEC. They have instead decided to pursue trade policy using a three-track approach based on (i) global (WTO-based) cum trans-regional (APEC-based), (ii) regional (ASEAN+3 or ASEAN+6), and (iii) bilateral liberalization. Regional and bilateral liberalization could achieve deeper integration with trading partners on a formal basis, going beyond reductions in border restrictions—pursuing investment liberalization, promoting greater competition in the domestic market, and harmonizing standards and procedures. The challenge is to maintain an appropriate balance between the regional and bilateral approach and the WTO liberalization framework, which remains an important element of the region's trade policy.

Table 4 identifies three types of FTA activity in East Asia by status, during 1976–2007: (i) concluded FTAs (those signed or under implementation); (ii) FTAs under negotiation (those being officially negotiated with or without a framework agreement being signed); and (iii) proposed FTAs (where parties issued joint statements with intention to negotiate an FTA, established a joint study group, or conducted a joint feasibility study to determine the desirability of establishing an FTA). As of 2000, only three FTAs had been concluded, one was under negotiation, and another three had been proposed.<sup>10</sup> Within 7 years, there was a ten-fold increase in FTAs concluded in East Asia and a larger increase in those under negotiation. By the end of October 2007, there were 37 FTAs concluded, 40 under negotiation, and 26 proposed. Today East Asia is at the forefront of FTA activity in Asia, with a total of 103 FTA initiatives at various stages—equivalent to about half of Asia's total FTA initiatives.<sup>11</sup> East Asia makes up two-thirds of FTAs under negotiation in Asia.

**Factors underlying FTA initiatives:** There are basically three factors behind recent FTA initiatives in East Asia: (i) the deepening of market-driven economic integration; (ii) the progress of European and North American economic integration; and (iii) the Asian financial crisis.<sup>12</sup>

First, the most fundamental factor behind the emergence of recent initiatives for FTAs is the progress of regional economic links and interdependence. Market-driven economic integration eventually requires policy measures to support and further it—that is, harmonization of policies, rules, and standards governing trade and FDI. Policymakers in East Asia are increasingly of the view that FTAs, if designed with a wide scope, can support expanding trade and FDI activities through further elimination of cross-border impediments, facilitation of trade and FDI, and harmonization of various rules, standards, and procedures. In this way, FTAs can be regarded as part of a supporting policy framework for the deepening production networks and supply chains formed by global multinational corporations and emerging East Asian firms.

Second, economic regionalism in Europe and North America—including the successful launch of an economic and monetary union by euro area countries and the expansion of the European Union (EU) to its eastern neighbors, as well as the success of NAFTA and its incipient move to the Free Trade Area of the Americas (FTAA) in North, Central, and

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<sup>10</sup> Prior to 2000, the concluded FTAs had been the Bangkok Treaty (1976) which is now known as the Asia-Pacific Trade Agreement (APTA), the Laos-Thailand PTA (1991), and the ASEAN FTA (1992).

<sup>11</sup> As of June 2007, there were 198 FTAs at various stages in Asia. Of these, 90 were concluded, 61 under negotiation, and 47 were proposed.

<sup>12</sup> More complete explanations can be found in Kawai (2005a).

South America—has motivated the East Asian economies to pursue regional trade arrangements. Governments in East Asia fear that the two giant blocs—the EU and the US—might dominate the rule-setting in the global trading system while marginalizing the role and weight of Asia in global competition and multilateral negotiations. They have increasingly realized the importance of stepping up their own process of integration and uniting themselves to strengthen bargaining power in the global arena, and raise the region’s voice in, and for, global trade issues. In addition, facing the slow progress of the WTO/Doha negotiation process and the perceived loss of steam in the APEC process, FTAs can be considered as an insurance policy against the periodic difficulties with multilateral trade liberalization.

Third, the Asian financial crisis of 1997/1998 has taught the important lesson that East Asia needs to strengthen economic cooperation in order to sustain economic growth and stability. The global initiative to strengthen the international economic system in this regard has been unsatisfactory, while the national efforts to strengthen individual economic fundamentals take time to bear fruit. Hence, the general sentiment in Asia has been that the region must establish its own “self-help” mechanism for economic management. The financial crisis nurtured the sense of a “region” with a common set of challenges.

### ***C. Evolving Economic Architecture in East Asia***

Several key groupings have formed involving East Asia: ASEAN and APEC, and over the past 12 years, ASEAN+3, East Asia Summit (ASEAN+6), and Asia-Europe Meeting (ASEM), among others.

**Association of Southeast Asian Nations (ASEAN):** established in August 1967, ASEAN had, until recently, been the only formal organization that pursued regional economic integration in East Asia. The ASEAN Declaration states that it aims to accelerate economic growth, social progress, and cultural development, and to promote regional peace and stability. The association has embarked on several economic integration initiatives, including the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS), and the ASEAN Investment Area (AIA). In December 1997, the ASEAN leaders adopted the ASEAN Vision 2020, which envisioned an outward looking organization living in peace, stability, and prosperity, bonded together in partnership in dynamic development and in a community of caring societies. In October 2003, the ASEAN leaders adopted the Declaration of ASEAN Concord II (Bali Concord II), whereby they agreed on the establishment by 2020 of an ASEAN Community comprising three pillars, namely, an ASEAN Security Community, an ASEAN Economic Community, and an ASEAN Socio-Cultural Community.

The lynchpin of the ASEAN economic integration initiative is AFTA, launched in January 1992, which aimed to establish a free trade area within 15 years. The Common Effective Preferential Tariff (CEPT) Scheme was introduced as the main mechanism for lowering intra-ASEAN tariffs to the 0–5% range.<sup>13</sup> Despite the slow pace of trade liberalization, since January 2002 AFTA has been in effect among the first six signatories—Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand—and

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<sup>13</sup> For products not covered by the Common Effective Preferential Tariff scheme (CEPT), the ASEAN Preferential Trading Arrangements could be used. The ASEAN Industrial Cooperation Scheme (AICO), introduced in April 1996, applies the CEPT rate of tariffs (0 to 5%) on approved AICO products to strengthen industrial cooperation among ASEAN-based companies.



successfully reduced tariffs on almost all products in the Inclusion List to the 0–5% range. Implementations have been delayed for newer members—for Viet Nam in 2006, Lao People’s Democratic Republic (Lao PDR) and Myanmar in 2008, and Cambodia in 2010. The six original signatories are expected to eliminate tariffs altogether by 2010 and the other four by 2015. By then all ASEAN will become a tariff-free FTA.

The AFAS, signed in December 1995, aims to substantially eliminate restrictions to trade in services among ASEAN members—by progressively improving market access and ensuring equal national treatment—and to improve the efficiency and competitiveness of ASEAN services suppliers. The AFAS was amended in September 2003 to allow for the application of “ASEAN minus x” formula in the implementation of services commitments. Under this formula, member countries that are ready to liberalize a certain service sector may proceed to do so without having to extend the concessions to non-participating countries. The AIA, adopted in October 1998, aims to make ASEAN a competitive, conducive, and freer investment area through liberalizing investment rules and policies in protected sectors and promote greater flows of capital, skilled labor, professional expertise and technology within the region. The AIA agreement has expanded to cover manufacturing, agriculture, mining, forestry and fishery sectors, and services incidental to these sectors.

The ASEAN Economic Community (AEC), one of the three pillars of the ASEAN Community, is expected to make ASEAN a single market and production base by 2020, with a free flow of goods, services, investment, a freer flow of capital, equitable economic development, and reduced poverty and socio-economic disparities.<sup>14</sup> To help this, new mechanisms and measures have been introduced to (i) strengthen the implementation of its existing economic initiatives including the AFTA, AFAS and AIA; (ii) accelerate regional integration in the priority sectors; (iii) facilitate movement of business personnel, skilled labor and talent; and (iv) improve the existing ASEAN Dispute Settlement Mechanism. In the Cebu Summit in January 2007, leaders decided to advance the time frame of the ASEAN Community, including the AEC, to 2015. In the Singapore Summit in November 2007, the leaders signed the *ASEAN Charter* to establish the group as a rules-based legal entity, improve decision-making, and accelerate economic integration.

**ASEAN+3:** The leaders of PRC, Japan, and Korea were invited to the informal ASEAN Leaders’ Meeting in December 1997, in the midst of the Asian financial crisis, which *de facto* initiated the ASEAN+3 process. There are many ministerial processes within the ASEAN+3 framework, for foreign affairs, economy and trade, macroeconomic and finance, environment, energy, health, labor, science and technology and social welfare, among others. In addition to economic ministers, finance ministers have been particularly active in regional financial cooperation, including the launch of the regional liquidity support arrangement (the Chiang Mai Initiative), the regional economic surveillance process, and Asian bond market development. The PRC regards ASEAN+3 as a natural grouping for East Asia’s trade and investment cooperation.

In November 2004, ASEAN+3 leaders agreed that the establishment of an “East Asian Community” is a long-term objective and affirmed the role of ASEAN+3 as the main

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<sup>14</sup> See Hew and Soesastro (2003) and Hew (2007) for a number of ideas on deepening ASEAN economic integration.

vehicle for its eventual establishment. The idea of creating an East Asian Community was proposed by the East Asia Vision Group in 2001.<sup>15</sup> Its principal aims include the

- establishment of an East Asian Free Trade Area (EAFTA) and liberalization of trade well ahead of the APEC Bogor Goal;
- expansion of the Framework Agreement on an ASEAN Investment Area (AIA) to all of East Asia;
- promotion of development and technological cooperation among the region's countries to provide assistance to those less developed; and
- realization of a knowledge-based economy and the establishment of a future-oriented economic structure.

The group envisioned a progressive integration of the East Asian economies, ultimately leading to an East Asian economic community. Once a region-wide FTA is formed, covering both trade and investment, and institutions for other types of regional cooperation are established, the basic foundation for an East Asian economic community will have been prepared. The ASEAN+3 leaders in 2002 received the final report of the East Asia Study Group (EASG), which was essentially government officials' responses to the Vision Group's recommendations, and identified 17 concrete short-term measures and nine medium- to long-term measures to move East Asian cooperation forward. In 2003, the leaders endorsed the implementation strategy of short-term measures—to be implemented by 2007—and in 2004 encouraged a speedy implementation of the short- and long-term measures of the EASG.

**East Asia Summit (ASEAN+6):** The November 2004 agreement by ASEAN leaders in Vientiane to convene an East Asian Summit (EAS) is one recent significant development. Creation of this new forum was suggested by the East Asia Vision/Study Group, but without a clear view of which countries should be its members. The first EAS meeting was held in Kuala Lumpur in December 2005, followed by Cebu in January 2007, and Singapore in November 2007, with the participation of all 13 ASEAN+3 members as well as Australia, India, and New Zealand. This wider group focuses on issues common to the wider participants, including avian flu, education, energy, finance and natural disasters. Japan regards ASEAN+6 as an appropriate group for East Asia's trade and investment cooperation and has proposed a Comprehensive Economic Partnership in East Asia.

Future economic cooperation in East Asia, leading to an East Asian economic community, is likely to evolve around the multiple agreements under the ASEAN, ASEAN+1, ASEAN+3, and East Asia Summit (EAS, or ASEAN+6) processes.<sup>16</sup> It is likely that the ASEAN Economic Community to be created by 2015 will be the center of East Asian economic cooperation. It is now understood that ASEAN is the driving force and ASEAN+3 the main vehicle for the realization of an eventual East Asian economic community, with the EAS “an integral part of the overall evolving regional architecture”.

**APEC and ASEM as trans-regional forums:** established in 1989, APEC has played a useful role in encouraging trade and investment liberalization on a voluntary and

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<sup>15</sup> The East Asia Vision Group, established in 1999 under the leadership of Korean President Kim Dae Jung, recommended (i) economic cooperation, (ii) financial cooperation, (iii) political and security cooperation, (iv) environmental cooperation, (v) social and cultural cooperation, and (vi) institutional cooperation.

<sup>16</sup> The ASEAN+1 processes include ASEAN+China, ASEAN+Japan, ASEAN+Korea, ASEAN+India, and ASEAN+CER mainly in the form of FTAs or comprehensive economic partnership agreements (EPAs).

unilateral fashion within an Asia-Pacific context that includes the US, Canada, and Australia, among others, as members. Australia played a major role in promoting APEC as a trans-regional forum with the basic principle of “open regionalism”—regional economic integration that is not discriminatory against outside countries. One of its most important achievements was to induce unilateral, voluntary trade liberalization of previously non-WTO members such as the PRC and Taipei, China. In addition, the Bogor Declaration of 1994 set the goal of zero tariffs by 2010 for developed countries and by 2020 for developing countries. The modality of achieving the Bogor goals was clarified in the so-called Osaka Action Agenda. Nonetheless, APEC’s prominence appears to have declined since the Asian financial crisis because of its inability to effectively respond to the crisis and the recent proliferation of bilateral and subregional FTAs pursued by the member economies. But open regionalism, as set out by APEC may remain important if members take APEC—and the WTO principles—as a liberalization infrastructure for their FTAs and attempt to go beyond such basic principles.<sup>17</sup>

The Asia-Europe Meeting (ASEM) was created in 1996 as a forum for Asia-European Union economic cooperation. Its membership initially covered five original ASEAN members, the PRC, Japan, Korea and EU members, but was later expanded to include all ASEAN members and, more recently, South Asian countries including India and Pakistan. ASEM has not been active as a forum for trade and investment liberalization, as in the case of APEC.

### III. Salient Characteristics of East Asian FTAs

There is a dearth of studies systematically mapping the trends and characteristics of East Asian FTAs.<sup>18</sup> This gap may be due to the recent origin of many East Asian agreements and the lack of comprehensive regional databases.<sup>19</sup> As a part of the international effort to promote transparency of FTAs in the Asia-Pacific region, the Asian Development Bank (ADB) launched the Asia Regional Integration Center (ARIC) FTA Database.<sup>20</sup> This section provides an analysis of trends and characteristics of East Asian FTAs, drawing on information from the ARIC FTA Database. It maps the coverage of trade, configuration, geographical orientation, WTO notification, scope (in terms of “WTO-plus” issues), and rules of origin.

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<sup>17</sup> In response to the proliferation of various FTAs in the Asia-Pacific region, APEC encourages its members to pursue a best-practice model of an FTA.

<sup>18</sup> Recent studies include Bonapace (2005), Feridhanusetyawan (2005), Baldwin (2007), and Chia (2007).

<sup>19</sup> FTA databases covering East Asian economies include the WTO RTA Gateway ([www.wto.org](http://www.wto.org)) and UNESCAP Asia-Pacific Trade and Investment Agreements Database ([www.unescap.org/tid/aptiad](http://www.unescap.org/tid/aptiad)). Although it covers global FTA activity, the WTO database only provides information on East Asian FTAs notified to the WTO. Concluded agreements not notified to the WTO, and those under negotiation and proposed, are excluded. The UNESCAP database provides summaries of FTAs undertaken by UNESCAP members, including some in East Asia.

<sup>20</sup> Launched in October 2006 by ADB, the ARIC FTA database ([www.aric.adb.org](http://www.aric.adb.org)) provides three types of information: (i) statistical tables on the status of FTAs in Asia; (ii) available information on each FTA (that is, legal documents, official summaries, studies, news, opinions, FTA membership and an external link to the UNESCAP database); and (iii) a comparative FTA toolkit which enables comparison of chapters/provisions of concluded Asian FTAs. The information is gathered from official sources, research sites, and online news items.

## **A. FTA Coverage of Trade**

**Role of richer, larger economies:** The recent increase in FTAs has been driven by five of the region's richer and larger economies—Singapore, Japan, Korea, PRC, and Thailand—suggesting a link between FTA growth and economic prosperity. For instance, these five economies were parties to 86% of concluded FTAs in East Asia by the end of October 2007.

Singapore is the most active East Asian economy and has the broadest geographical coverage of agreements. It is a member of AFTA and has implemented or concluded agreements with the largest economies in East Asia (PRC [through ASEAN], Japan, and Korea) as well as outside (including the US, India, and Australia). Japan has implemented or concluded agreements with six East Asian countries (Brunei Darussalam, Indonesia, Malaysia, Philippines Singapore, and Thailand) and two outside (Chile and Mexico). Korea has agreements with APTA, ASEAN, and Singapore within East Asia and outside with Chile and the European Free Trade Agreement (EFTA) countries. It also signed the region's biggest agreement with the US in June 2007. Within East Asia, the PRC has agreements with ASEAN; Hong Kong, China; Thailand (through ASEAN); APTA; Macao; and outside with Chile and Pakistan. Thailand is also a member of AFTA and has agreements with PRC (through ASEAN), Japan, Lao PDR, Australia, and New Zealand.

With some exceptions, the region's poorer economies (notably, Cambodia, Lao PDR, Viet Nam, Philippines, and Indonesia) have tended to rely on ASEAN for concluding FTAs with its larger economies. This may reflect weak institutional capacity and resources for undertaking FTA negotiations. The ASEAN framework allows the pooling of scarce capacity and resources.

**FTA coverage of trade:** It is informative to get an idea of how much of a country's trade is covered by FTA provisions.<sup>21</sup> This is difficult to measure accurately because of exceptions and exclusions contained in many agreements. Furthermore, data on utilization rates of FTA preferences are hard to come by and data on direction of services trade do not exist. Nevertheless, by making the bold assumption that all goods trade is covered by concluded FTAs, estimates can be obtained. Figure 1 shows the ratio of a country's bilateral trade with its FTA partners to the country's total trade with the world for 2006. In general, ASEAN members have higher shares than the region's larger economies indicating a greater reliance on FTAs. Within ASEAN, four countries (Lao PDR, Brunei Darussalam, Singapore, and Myanmar) have shares in excess of 65% while the others have shares in the range of 35% to 52%. The shares of East Asia's large economies are: Korea (46%), PRC (29%), and Japan (14%). Meanwhile, the share of Hong Kong, China is 46% while that of Taipei, China is only 0.1%. By comparison, others like Australia, New Zealand, and India have shares of under 28%.

## **B. Configuration, Geographical Orientation, WTO Notification and Scope**

**Configuration: bilateral vs. plurilateral FTAs :** The configuration of FTAs in East Asia can be divided into bilateral and plurilateral as in Table 5 for 2007. Bilateral FTAs refer to agreements between two countries. Plurilateral FTAs include several forms—agreements involving more than two countries, one country (or countries) and a trading

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<sup>21</sup> See Fiorentino, Verdeja and Toqueboeuf (2007) on this point.

bloc (like ASEAN), or two trading blocs (for example, ASEAN-EU).<sup>22</sup> On the whole, countries are opting for bilateral FTAs rather than the more complex plurilateral ones as they may be easier to negotiate. There were 28 bilateral FTAs (76% of total) and 9 plurilateral FTAs<sup>23</sup> (24% of total) among 37 concluded FTAs as of October 2007. Bilateral FTAs also dominate FTAs that are yet to be concluded, making up 75% of those under negotiation and 69% of those proposed.

Among the nine concluded plurilateral agreements, AFTA stands out for its economic importance in the region and as a natural hub for East Asia's FTA activities. ASEAN has also become a focal point for the emergence of a new category of trading-bloc to trading-bloc agreement (for example, the ASEAN-EU Free Trade Agreement and the ASEAN-Australia and New Zealand Free Trade Agreement). The other concluded plurilateral agreements connect various East Asian countries with others outside the region. For instance, the Asia Pacific Trade Agreement (APTA) covers East Asia (PRC, Korea, and Lao PDR) and South Asia (Bangladesh, India, and Sri Lanka). There are also 10 plurilateral agreements under negotiation and another eight proposed.

**Geographical orientation: intra-regional versus extra-regional FTAs.** Table 5 also shows the geographical orientation of East Asian FTAs with countries/groups within the region and those outside. The high degree of extra-regional orientation of East Asian FTAs is striking—24 concluded FTAs out of 37 in October 2007 (65% of total) are with countries or groups outside East Asia. The extra-regional orientation of East Asian FTAs under negotiation and proposed is even higher at 90% and 85%, respectively.

Both bilateral and plurilateral FTAs show high degrees of extra-regionalism in a sample of 103 FTAs (including both concluded and non-concluded)—21 of the plurilateral agreements and 61 of the bilateral agreements are with countries/groups outside East Asia. ASEAN is considering negotiations with the EU and has begun negotiations with India, Australia, and New Zealand. Singapore has concluded eight extra-regional agreements with a wide geographical spread from Latin America to the Pacific. PRC, Korea, Japan and Thailand have concluded FTAs with Latin American countries. The PRC has concluded FTAs with Chile and Pakistan, and is negotiating FTAs with Australia, New Zealand, the Gulf Cooperation Council and Iceland. Thus, East Asian economies have a strong preference to maintain open trading relations with the rest of the world rather than becoming inward-looking (Kawai, 2005a).

**WTO notification:** A breakdown of the 37 concluded East Asian FTAs by WTO notification status shows that 51% (19 FTAs) had been notified to the WTO as of October 2007, although the figure is set to rise because 11 of the 18 FTAs not yet notified to the WTO were only concluded in 2006–2007. These findings indicate significant adherence in East Asia to WTO rules and procedures on FTAs. In addition,

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<sup>22</sup> An issue may arise when a trading bloc with a single authority (like the EU forms an FTA with a country. Though such an FTA may be considered bilateral, it is plurilateral in our definition as in the case of the Singapore-EU or Korea-EFTA FTA. Other definitions of bilateral and plurilateral FTAs exist in the literature. For instance, Crawford and Fiorentino (2005) define a bilateral agreement as one which may include more than two countries where one of them is a trading bloc itself (for example, the ASEAN-PRC FTA) while a plurilateral agreement refers to an FTA in which the number of FTA partners exceeds two. If we reclassify our data according to this definition, there would be even more bilateral FTAs in East Asia (92 bilateral agreements and 11 plurilateral agreements).

<sup>23</sup> They are: the APTA; AFTA; the Preferential Trade Agreement-Group of Eight Developing Countries; Trans-Pacific Strategic Economic Partnership Agreement; ASEAN-PRC FTA; ASEAN-Korea FTA; Korea-EFTA FTA; Singapore-EFTA FTA; and the Taipei,China-EI Salvador-Honduras FTA.

with a growing tendency for notification of East Asian FTAs under the GATT/GATS framework (15 concluded FTAs), notifications under the Enabling Clause have remained static (4 concluded FTAs).<sup>24</sup> All 15 concluded FTAs notified under GATT Article XXIV are also notified under GATS Article V. One interpretation is that East Asian FTAs are getting more comprehensive in scope over time, and extending beyond tariff preferences for some goods into services and regulatory issues.

**Scope (“WTO-plus” issues):** Studies of FTAs conducted outside East Asia report two interesting findings about their scope:<sup>25</sup> (i) many recent agreements frequently go beyond the WTO regulatory framework to include provisions on a host of issues (trade facilitation, investment, government procurement, competition, intellectual property, environment and labor, among others); and (ii) FTAs between developed and developing countries often include such provisions, which may reflect the emphasis that developed economies place on these issues. The four “Singapore issues” (trade facilitation, investment, government procurement, and competition policy) were conditionally included in the work program for the Doha Round in November 2001, but were subsequently dropped at the WTO Ministerial Conference in Cancun in 2004. Accordingly, agreements containing such provisions are sometimes referred to in the literature as “WTO-plus” agreements. How prevalent are WTO-plus FTAs in East Asia?

Table 6 classifies 35 concluded FTAs in East Asia into four types according to increasing scope: (i) goods only; (ii) goods and services; (iii) goods, services and Singapore issues; and (iv) goods, services, Singapore issues, and cooperation enhancement.<sup>26</sup> Cooperation enhancement refers to additional WTO-plus provisions (such as labor standards, information technology cooperation, small and medium enterprises [SME] and the environment) that are included in some agreements along with the Singapore issues. It is noteworthy that the majority of concluded East Asian FTAs in 2007—24 (or 69% of the total)—had WTO-plus provisions in addition to goods and services provisions. Of these, nine had the Singapore issues only, while another 15 were even more comprehensive in scope (with both the Singapore issues and cooperation enhancement provisions). This indicates that East Asian economies typically favor comprehensive, WTO-plus agreements rather than agreements only in trade in goods and services.<sup>27</sup>

Nonetheless, even the most comprehensive East Asian FTAs vary in their coverage of WTO-plus provisions, reflecting economic interests, bargaining power, and negotiating capacity. Table 7 maps the provisions relating to the four Singapore issues and 16 categories of cooperation enhancement in 15 such agreements. With the exception of

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<sup>24</sup> The 1979 Enabling Clause provides for the mutual reduction in tariffs on trade in goods among developing countries. It also allows for developed countries to give a reduction in tariffs to developing countries but not necessarily on a reciprocal basis. Article XXIV of GATT sets rules for FTAs in the area of goods and Article V of the GATS for services.

<sup>25</sup> For example, see Crawford and Fiorentino (2005); World Bank (2005), and Fiorentino, Verdeja, and Toqueboeuf (2007)

<sup>26</sup> As of October 2007, there were 37 concluded FTAs in East Asia. However, the Taipei,China and Nicaragua FTA and Taipei,China-El Salvador-Honduras FTA could not be included in Table 6 because the texts were not available.

<sup>27</sup> Our findings on the comprehensive WTO-plus scope of East Asian FTAs thus confirm those of Banda and Whalley (2005) for FTAs involving more developed ASEAN members (for example, Malaysia, Singapore, and Thailand). They observe that FTAs concluded by these countries go beyond WTO disciplines and deal with competition policy, mutual recognition, movement of persons, investment, and cooperation in specific areas.

the Singapore-Jordan FTA, most of these FTAs provide for universal or near-universal coverage of the Singapore issues. The coverage of cooperation enhancement is patchier, but sensitive new issues are reasonably well covered. For instance, intellectual property is included in 13 FTAs, the environment in 10 FTAs, labor standards in nine FTAs, and e-commerce in seven. As a crude summary measure of FTA comprehensiveness, the last row of Table 7 also provides the ratio of a given FTA's WTO-plus provisions to the total possible WTO-plus provisions in the most comprehensive agreement. With ratios in excess of 55%, the Japan-Thailand EPA, the Japan-Brunei Darussalam EPA, the Korea-Singapore FTA, the Japan-Philippines EPA, the Japan-Indonesia EPA, and the Korea-US FTA have the highest coverage of WTO-plus provisions. Meanwhile, the Singapore-Jordan FTA has the lowest. In between (with ratios of 30–50%) come the remaining FTAs. Thus, international trends towards the expanding scope of FTAs are broadly confirmed in East Asia, but there is still room to expand WTO-plus provisions in existing and new FTAs.

In general, developed countries (Australia, Japan, New Zealand, and US) seem to prefer a WTO-plus format of agreement with developing countries in the region and 16 of the WTO-plus agreements involve developed and developing countries (see Table 6). Many of the FTAs that contain only goods and services trade provisions are basically between developing countries (and Korea and Singapore behave much like a developing country when they act together with ASEAN members). Otherwise, Korea or Singapore tend to act like developed countries—that is, they form FTAs with WTO-plus elements—when the partner is a developing country.

### ***C. Multiple Rules of Origin***

Rules of origin (ROOs)—which exist to determine which goods will enjoy preferential bilateral tariffs and thus prevent trade deflection among FTA members—are a particularly interesting aspect of East Asian FTAs. For manufactured goods, ROOs may be of three types: (i) a change in tariff classification (CTC) rule defined at a detailed Harmonized System (HS) level; (ii) a local (or regional) value content (VC) rule which means that a product must satisfy a minimum local (or regional) value in the country (or region) of an FTA; and (iii) a specific process (SP) rule which requires a specific production process for an item.

Table 8 provides an overview of the main ROOs adopted by 31 concluded FTAs in East Asia.<sup>28</sup> Strikingly, the majority of FTAs in East Asia (21) have adopted a combination of the three ROOs rather than applying a single rule. Of the remaining FTAs, three use the VC rule only, another three use the VC and/or CTC rule, and another four use the VC and/or SP rule. The simplest ROO can be found in the AFTA and the ASEAN-PRC FTA, which specifies a 40% regional VC across all tariffs. Meanwhile, many agreements involving Japan, Korea, and Singapore tend to use a combination of ROOs. The latter introduces complexity and additional costs for business.

Further insights are provided by looking at the ROOs applied to the major auto and auto parts products in 11 major concluded FTAs (see Table 9). ASEAN's FTAs vary somewhat in their ROOs. For instance, the 40% VC rules applies for AFTA and for the ASEAN-PRC FTA but more stringent ROOs for some products (for example, 45% VC applied for HS 8703, 8704, and 8708) are found in the ASEAN-Korea FTA. Furthermore,

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<sup>28</sup> For six of the 37 concluded FTAs, the texts (and hence ROO provisions) were not available.

the ROOs for the same products are different in bilateral FTAs involving the same major economy. In the Japan-Malaysia FTA, the VC requirement for HS8703 and 8711 is 60% while in the Japan-Thailand FTA, it is 40% for the same two products. Similarly instances can be found in the case of Singapore-Australia FTA and Thailand-Australia FTA.

Studies of ROOs in East Asia indicate that complex ROOs can raise transaction costs to business firms and that multiple ROOs in overlapping FTAs can be particularly burdensome, giving rise to the noodle bowl effect.<sup>29</sup> The textile and garment sector tends to be affected by stringent and restrictive ROOs. Precise quantitative estimates of the magnitude of the costs of multiple ROOs (for example, as a percentage of export sales) are hard to come by. Using a gravity model, Manchin and Pelkmans-Balaoing (2007) obtain results that suggest that the administrative costs of obtaining CEPT status within AFTA might be in the range of 10–25% and that such costs are not much reduced even when an alternative rule for origin determination is provided. One of the implications is that the presence of multiple ROOs may further increase administrative costs.

**Results of firm surveys:** Firm surveys are useful to highlight the business impact of multiple ROOs in East Asia. Insights at a regional level are provided by a Japan External Trade Organization (JETRO) survey of Japanese multinational corporations which are a major driver of production networks and intra-regional trade (see Table 2). Of 97 Japanese multinational corporations using (or planning to use) FTA preferences in East Asia in 2006, about 30% felt that the existence of multiple ROOs could lead to increased costs to exporting—either through dealing with complicated procedures to prove country of origin or changes in production processes (JETRO, 2007). Another 33% of Japanese multinational corporations thought that proliferating FTAs and ROOs would lead to increased costs to exporting in the future. Finally, a majority of Japanese multinational corporations (64%) were in favor of harmonizing East Asia’s ROOs, with the largest number (25%) wanting to be able to choose either the value content (VC) rule or the change in tariff classification (CTC) as the common rule.

Additional evidence from Thailand (at the center of production networks in automobiles and electronics and with five major FTAs in effect)<sup>30</sup> is available from a 2007 ADB survey of 118 multinational corporations and domestic firms (Wignaraja *et al.*, 2007). Tariff preference utilization rates in Thai FTAs seem quite high, with about 60% of sample firms using or planning to use preferences. The challenge of dealing with multiple ROOs is apparent with 22% of firms reporting that ROOs in Thailand’s FTAs were an obstacle to using FTA preferences while another 23% said ROOs might be a future obstacle. On average, the firms estimated that the business costs of handling multiple ROOs (for example, hiring ROO specialists or changing production processes) were less than 1% of export sales, which could be significant in highly cost-competitive export sectors. Interestingly, Thai domestic enterprises (particularly SMEs) seemed more concerned than multinational corporations about the costs of dealing with multiple ROOs underlining the large corporations’ superior ability to deal with ROOs (better access to technical know-how). Accordingly, domestic Thai enterprises argued for enhanced information, training, and technical support from the government and business associations. Finally, firms said that FTAs had an impact on their business plans, with

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<sup>29</sup> See Cheong and Cho (2006), James (2006) and Lee, Jeong, Kim and Bang (2006).

<sup>30</sup> These were the ASEAN FTA, the ASEAN-PRC FTA, the Thailand-Australia FTA, the Thailand-New Zealand Closer Economic Partnership Agreement, and the India-Thailand FTA (early harvest).



58% reporting that they had changed or were planning to change business plans in response to FTAs.

The available evidence suggests that multiple ROOs are becoming a problem in East Asia (with a disproportionate effect on domestic firms—especially SMEs) and that additional policy and institutional support may be required for enterprise adjustment. There is a need for regular firm-level surveys in East Asia to monitor the business impact of multiple ROOs and to further the business case for harmonization of ROOs in East Asian FTAs.

#### **IV. POLICY ISSUES AND IMPLICATIONS**

##### ***A. Maximizing the Benefits, and Minimizing the Costs, of FTAs***

FTAs carry benefits and costs, and designing them to maximize benefits is, naturally, the most desirable strategy. With nearly all East Asian economies currently pursuing FTAs, crafting them in a way that induces domestic structural reforms and ensures consonance with WTO rules is a realistic approach to maximizing benefits.

**Benefits and costs of FTAs:** If designed properly, FTAs can achieve dynamic gains by generating greater trade and FDI among members, through liberalization of trade in goods and services and facilitation of trade and FDI market access. FTAs can also help achieve deeper economic integration through the WTO-plus agreements, including many areas not covered by the WTO negotiations and areas in which it is difficult to make substantial progress within a multilateral framework (OECD, 2003)—investment provisions, intellectual property rights, labor mobility, environmental issues, and regulatory harmonization. FTAs between FDI source and recipient economies would allow the latter to obtain advanced technologies, connect with external markets, and promote trade, industrialization, employment and economic growth. These dynamic gains can generate trade and FDI with non-members as the members grow faster as a result of FTAs. These benefits are large if FTAs can induce difficult domestic structural reforms. Once such structural reforms are pursued, it is much easier for the country to provide greater market access to non-members through WTO or other FTAs.

One of the most serious costs of FTAs is that they discriminate against non-members, particularly small, poor, developing economies which cannot join FTAs as they do not have much to offer and hence cannot attract interest from others. The costs of FTA negotiations could also be large for small, poor economies with limited negotiation capacity—such as Cambodia, Lao PDR, Myanmar, and Viet Nam—particularly when gains from FTAs are unevenly distributed across various participating countries. The proliferation of many overlapping FTAs with different rules of origin and standards can create the risk of Asian noodle bowls, thereby reducing incentives for businesses to use the intended freer trade arrangements. This may particularly be true for SMEs which may face higher administrative and business costs because their capacity to deal with them is limited.

With or without the success of the WTO Doha Round, the trend toward more FTAs will continue. Hence, there is an even more urgent need to make FTAs a stepping stone toward greater liberalization of trade and FDI and toward further regional and, ultimately, global integration. For this purpose, East Asia needs to design best practice FTAs so

that their benefits can be maximized and costs minimized. The region must also manage the proliferation of FTAs so that they function as a means for reducing domestic protection and expanding trade and FDI. For this purpose, FTAs must enforce substantial domestic structural reforms to allow domestic industries to cope with greater competition from abroad.

**WTO consistency, breadth, and depth:** In addition to domestic structural reforms, each FTA can be made more multilateral-friendly and consistent with GATT Article XXIV and GATS Article V by adopting (i) the lowest tariff rates among members; (ii) large membership; comprehensive coverage of liberalization measures (goods, services, investment, and beyond); (iii) elimination of exclusions; (iv) simple and non-restrictive rules of origin; and (v) harmonized regulatory and institutional frameworks. In this regard, actions like the APEC Best Practice Guidelines for FTAs, the various trade and investment harmonization initiatives of ASEAN (for example, the ASEAN Investment Area) and periodic meetings of ASEAN with outsiders (for example, the EU and the US) are steps toward multilateralizing East Asian FTAs.

One point is worth noting: the larger the number of participating countries in an FTA and the wider the coverage of liberalization measures and policy issues addressed, the more benefits there are for an FTA. Hence, there is a need to broaden the country coverage of FTAs and, from this perspective, aim for an ASEAN+3 or an ASEAN+6 FTA. There is also a need to deepen FTAs in terms of liberalization measures and policy issues and, from this perspective, include a wide range of trade in goods (both manufactured and agricultural) and services as well as WTO-plus issues—that is, investment, labor migration, intellectual property rights, competition policy, non-restrictive rules of origin, and dispute settlement.

There usually exists a trade-off between the size and depth of an FTA, that is, as the number of countries participating in an FTA rises, the scope of measures and issues to be addressed in the FTA may be limited. In other words, an FTA with a limited number of countries can relatively easily achieve deep economic integration, while an FTA with a large number of countries may have to compromise on depth. Therefore a good balance must be sought between breadth (number of participating countries) and depth (measures to be addressed) in an FTA.

**Consolidation into an ASEAN+3 or ASEAN+6 FTA?** Because coordination of rules of origin and harmonization of standards at the global level would be most desirable, all FTAs would better be consolidated into a single world-wide FTA to reduce the business costs. But given the politically difficult task of global (WTO) trade liberalization, consolidation into a single East Asia-wide FTA can make a significant positive contribution. The question is: what is the best natural group for East Asian FTA consolidation?

ASEAN is clearly a natural hub for the creation of an East Asian FTA because key production networks are rooted in ASEAN and major economies are linking to ASEAN via ASEAN+1 FTAs. This is also true because the timeline for the ASEAN Economic Community has been brought forward to 2015. An East Asian FTA may be built upon ASEAN+1 FTAs as a building block, and FTAs among subsets of non-ASEAN countries (that is, Australia, PRC, India, Japan, Korea, and New Zealand) will also be useful in forming a single East Asian FTA with ASEAN as its core.

Our computable general equilibrium (CGE) model results indicate a large income gain from an ASEAN+3 FTA and an even larger gain from an ASEAN+6 (East Asia Summit) FTA—the former yields a gain in world income of \$214 billion compared with \$260 billion for the latter (see Appendix 1 for details). Hence, East Asia is recommended to aim for an ASEAN+6 FTA. However, one of the challenges is likely to be the differing levels of openness and market-orientation of the larger membership. Table 10 provides three proxy indicators (average import tariffs, time for import, and time to start a business) to represent openness and market-orientation of the member countries. India is a relative latecomer to economic reforms, which began in the 1990s (see Panagariya, 2004; WTO, 2007) and, as a result, has relatively high import tariffs (15.7%) and longer time required for importation to take place (41 days) than the averages for ASEAN (9.5% and 32 days, respectively), for the Northeast Asian economies, and for Australia-New Zealand. The time taken to start a business in India (35 days) is also higher than for more developed economies in the region (for example, Singapore, Japan, Korea, Australia, New Zealand). Accordingly, differences in openness and market-orientation between India and other ASEAN+6 FTA partners may prolong negotiations and reduce the scope of FTA coverage/liberalization. Further structural reforms in India will be required before it initiates formal ASEAN+6 FTA negotiations. Hence, the appropriate sequencing could be to start with an ASEAN+3 FTA and then move to an ASEAN+6 FTA as conditions are created for ensuring sufficient depth of integration within ASEAN+6 countries.

The CGE computation also indicates a negative impact of an ASEAN+3 or ASEAN+6 FTA on the US which, though small, needs to be addressed by maintaining openness. After the completion of an ASEAN+3 or ASEAN+6 FTA, East Asia may be ready to connect itself with North America (as well as with Europe).

### ***B. Providing Complementary Support***

The ambitious economic integration initiative among ASEAN nations—through acceleration of the AFTA process and creation of the ASEAN Economic Community—and the formation of various ASEAN+1 FTAs and a future ASEAN+3 or an ASEAN+6 FTA, would increase the efficiency and competitiveness of ASEAN as a whole, because these arrangements provide the benefit of scale economies and dynamic efficiency. To be successful, individual ASEAN members need to create favorable climates for competitive, private firms to prosper, while allowing weak, inefficient firms to exit through pro-competition policies, effective insolvency procedures, and a reduction in structural rigidities in their economies. Domestic industrial restructuring is surely needed to enable them to climb up the value-added product ladder. A shift to a knowledge-based economy is crucial for Malaysia and Thailand, and institutional and governance reforms and restoration of a good investment climate should be priorities for Indonesia and the Philippines.

Low-income ASEAN countries (Cambodia, Lao PDR, Myanmar and Viet Nam) must strengthen the structural, institutional foundations of their economic systems—through building hard infrastructure such as transportation and telecommunications facilities and soft infrastructure such as legal, judicial and governance systems—and develop skilled human resources. With its open FDI-trade regime, Viet Nam has been following the PRC's development path while still in need of improved governance, rule of law and institutions for a well-functioning market economy. Though Cambodia is beginning to participate in the regional and global production networks—particularly in textiles and apparel—it must strengthen the fundamental underpinnings of the economy, particularly

its legal institutions and public sector, to benefit from WTO entry. Lao PDR faces similar, perhaps more demanding, challenges. Myanmar clearly needs to improve its governance regime.

The international community is encouraged to provide various types of financial and technical support to enable ASEAN countries to cope with such demanding challenges. Many economies need trade-related infrastructure (national or cross-border transport, and logistics, for example.) and support for trade facilitation and customs modernization, for enhancing SME trade and finance; to support capacity building on trade policymaking, reform, and negotiation. They also need technical support for improving information transparency and educating businesses and the public about the potential benefits of trade and FDI openness, including through FTAs. The greatest challenge is to narrow the development gaps within ASEAN between its advanced members and less advanced members (CLMV), so that ASEAN can accelerate its own economic integration process—to forge the ASEAN economic community and deepen its economic relationships with the plus-three or plus-six countries.

## **V. Conclusion: Challenges Ahead**

Economic regionalism is taking root in East Asia. The region is becoming highly integrated through market-driven trade and FDI activities and, at the same time, FTAs are proliferating. The paper has argued that consolidation of multiple and overlapping FTAs into a single East Asian FTA can help mitigate the harmful noodle bowl effects of different ROOs and standards. This move will encourage the participation of low-income countries in freer trade arrangements, reduce trade-related business costs, particularly for SMEs, and promote trade and investment.

The paper has also suggested that WTO-plus elements need to be further expanded and that the consolidation at the ASEAN+6 level would yield the largest gains to East Asia among plausible regional trade arrangements—while the losses to non-members are relatively small. For such consolidation to occur, ASEAN must act as the regional hub by further deepening ASEAN economic integration, the plus-three countries (PRC, Japan, and Korea) need to collaborate more closely, and India needs to pursue further structural reforms. Furthermore, substantial international support is required to strengthen the supply-side capacity of poorer ASEAN countries—including the building of trade-supporting infrastructure (transport, energy, and telecommunications)—so that they can take advantage of integrated regional markets and narrow development gaps within ASEAN.

Relationships with the US (and the EU) are important for the region. For many East Asian economies, the US is the crucial ally from a security perspective, particularly given the geopolitical concerns on the Korean Peninsula. APEC remains important for East Asia and the US because it is the only multilateral economic forum that connects the US with East Asia. A natural approach for East Asia is to strengthen economic ties with the US through the formation of an East Asia-North America Free Trade Area FTA (or an FTA for Asia-Pacific). While several East Asian countries have agreed on bilateral FTAs with the US, some have reservations about a comprehensive agreement with the US. Deeper questions also remain as to whether the US is ready to agree to an FTA with East Asia—one that includes the PRC—and whether the US trade promotion authority (which expired in June 2007) will be extended.

While consolidation of FTAs within East Asia is clearly desirable, and an eventual connection with the US (and Europe) is next on the agenda, it is important for the East Asian economies to make bilateral and plurilateral FTAs more multilateral-friendly. They can do so by further pursuing some of the positive practices they have taken over the years and by adopting some innovative measures:

- Unilateral reduction of most favored nation (MFN) tariffs (such as through APEC);
- Coordination of dates of completion of various FTAs in the region, with phased elimination of exclusions, particularly in small, poorer countries;
- Inclusion of as many WTO-plus elements as possible in FTAs, with the formation of a wider investment area;
- Adoption of simpler ROOs (like 40% regional VC rule);
- Periodic consultation of the plurilateral group with outsiders to coordinate on trade and FDI issues; and
- Allow cumulative VC requirements across countries that conclude FTAs with each other.

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**Table 1: Intra-Regional Trade Share, 1980–2006 (%)<sup>1</sup>**

Region	1980	1985	1990	1995	2000	2001	2002	2003	2004	2005	2006
NIEs (4) <sup>2</sup>	8.6	9.2	11.9	15.5	15.5	15.3	15.8	15.2	14.6	13.9	13.6
ASEAN (10) <sup>3</sup>	17.9	20.3	18.8	24.0	24.7	24.1	24.4	26.6	26.7	27.2	27.2
ASEAN + PRC; Korea; Hong Kong, China; Taipei,China (14)	22.7	27.2	33.0	39.1	40.6	41.1	43.4	44.7	45.2	45.5	45.8
ASEAN+3 (13) <sup>4</sup>	30.2	30.2	29.4	37.6	37.3	37.1	37.9	39.0	39.2	38.9	38.3
ASEAN+3 + Hong Kong, China + Taipei,China (15)	36.8	39.0	43.1	51.9	52.1	51.9	53.8	55.4	55.9	55.4	54.5
ASEAN+6 (16) <sup>5</sup>	34.6	34.8	33.7	40.8	40.5	40.6	41.3	42.4	43.0	43.1	42.6
ASEAN+6 + Hong Kong, China + Taipei,China (18)	40.5	42.7	46.3	54.5	54.6	54.5	56.3	57.7	58.5	58.4	57.6
NAFTA (3)	33.8	38.7	37.9	43.1	48.8	49.1	48.4	47.4	46.4	46.1	44.3
MERCOSUR	11.1	7.2	10.9	19.2	20.3	17.9	13.6	14.7	15.2	15.5	15.7
Old EU (15)	60.7	59.8	66.2	64.2	62.3	62.2	62.5	63.0	62.2	60.4	59.5
New EU (27)	61.5	60.0	66.8	66.9	66.3	66.7	67.4	68.1	67.6	66.2	65.8

## Notes:

<sup>1</sup> Intra-regional trade share is computed as  $X_{ii} / [(X_{iw} + X_{wi}) / 2]$ , where  $X_{ii}$  is the value of intraregional exports,  $X_{iw}$  is the value of total exports of the region to the world, and  $X_{wi}$  is the value of total exports of the world to the region.

<sup>2</sup> NIEs = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China.

<sup>3</sup> ASEAN = Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.

<sup>4</sup> ASEAN+3 = ASEAN plus People Republic of China, Japan, and Korea.

<sup>5</sup> ASEAN+6 = ASEAN+3 plus Australia, India, and New Zealand.

Sources: IMF *Direction of Trade Statistics* CD-ROM (June 2007). Data for Taipei,China 1989–2006 from the Bureau of Foreign Trade website, and 1980–1988 from the *Statistical Yearbook* published by the Directorate-General of Budget, Accounting and Statistics.

**Table 2: Emerging East Asia's Foreign Direct Investment (FDI) Inflows, 1995–2005**

FDI Inflows to <sup>1</sup>	FDI Source						Total (\$ million)
	United States	European Union	Japan	NIEs	ASEAN9		
	%	%	%	%	%	%	
NIEs	16.8	15.8	8.1	5.2	3.9	100.0	(437,999)
Hong Kong, China	5.1	7.4	5.7	5.3	1.8	100.0	(215,999)
Korea, Rep. of	22.4	40.1	13.3	4.1	7.4	100.0	( 55,975)
Singapore	31.7	19.3	8.5	4.0	5.8	100.0	(142,748)
Taipei,China	19.9	13.1	15.5	14.2	2.5	100.0	( 23,277)
ASEAN9 <sup>2</sup>	18.4	29.1	19.1	29.2	4.2	100.0	(116,413)
Indonesia	5.7	50.9	3.3	15.0	9.3	100.0	( 11,839)
Malaysia	27.4	23.4	13.6	22.0	2.1	100.0	( 44,651)
Philippines	23.4	10.3	23.1	16.9	1.1	100.0	( 13,709)
Thailand	10.5	10.5	25.1	27.6	0.9	100.0	( 37,428)
Viet Nam	4.8	19.1	14.4	39.2	6.6	100.0	( 18,225)
China, People's Rep. of	8.1	8.1	8.6	54.0	1.6	100.0	(537,163)
<b>Total</b>	<b>13.9</b>	<b>14.7</b>	<b>10.5</b>	<b>34.9</b>	<b>3.1</b>	<b>100.0</b>	<b>(992,516)</b>

## Notes:

<sup>1</sup> FDI recipient data compiled by IITI are adjusted for consistency with balance of payments figures.

<sup>2</sup> ASEAN9= ASEAN minus Singapore.

Sources: UNCTAD, *World Investment Report 2006*; IMF, *International Financial Statistics*; ASEAN Secretariat for Singapore and ASEAN9 data; *China Statistical Yearbook* for People's Republic of China data; OECD data for Republic of Korea data; Institute for International Trade and Investment (IITI) for Hong Kong, China and Taipei,China data.

**Table 3: Liberalization Timeframe for Major Economic Groups in East Asia**

Group/FTA (Year of full negotiation completed)	For ASEAN Members		
	For Partner Countries	Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand	Cambodia, Lao PDR, Myanmar, Viet Nam
APEC (voluntary & unilateral)	2010	2020	2020
ASEAN (1992)	—	2003 (0% tariff by 2010)	2006–10 (0% tariff by 2015); ASEAN Economic Community to be launched by 2015
ASEAN+PRC (2010)	2007 (PRC)	2007	2010
ASEAN+Korea (2008)	2008 (Korea)	2010 (excl. Thailand)	2015 (flexibility allowed)
ASEAN+Japan (2007)	2010 (Japan)	2012	2018
ASEAN+India (2011)	2011 (India)	2011 (excl. Philippines)	2016 (incl. Philippines)
ASEAN+CER (Australia and New Zealand) (2009)	2010 (CER)	2017	2017

Source: Authors' compilation.

**Table 4: Growth of FTAs in East Asia, 1976–2007 (cumulative FTAs)**

Year	No. of FTAs	Concluded <sup>1</sup>	Under Negotiation <sup>2</sup>	Proposed <sup>3</sup>
1976	1	1	0	0
1986	1	1	0	0
1996	4	3	0	1
2000	7	3	1	3
2001	10	5	2	3
2002	14	6	4	4
2003	23	9	5	9
2004	42	14	16	12
2005	67	21	30	16
2006	96	31	42	23
2007 <sup>4</sup>	103	37	40	26

Notes:

<sup>1</sup> Concluded FTAs include those signed and/or under implementation.

<sup>2</sup> FTAs under negotiation cover those with or without a signed Framework Agreement.

<sup>3</sup> Proposed FTAs include official pronouncements of parties to negotiate an FTA or actually conduct a feasibility study.

<sup>4</sup> Data as of 31 October 2007.

Source: Compiled from ADB FTA Database, *Asia Regional Integration Center* (aric.adb.org).

**Table 5: Number of FTAs in East Asia, 2007**

FTAs by Status <sup>1</sup>	No. of FTAs	By Configuration <sup>2</sup>		By Geographic Orientation <sup>3</sup>	
		Bilateral	Plurilateral	Intra-East Asia	Extra-East Asia
Concluded	37	28	9	13	24
Under Negotiation	40	30	10	4	36
Proposed	26	18	8	4	22
<b>Total</b>	<b>103</b>	<b>76</b>	<b>27</b>	<b>21</b>	<b>82</b>

Notes:

<sup>1</sup> See Table 4 for definitions

<sup>2</sup> Bilateral FTAs involve only two parties, while plurilateral FTAs involve more than two parties (for example, ASEAN).

<sup>3</sup> Intra-East Asia FTAs are those among East Asian economies only, while extra-East Asian FTAs are those between at least one East Asian economy and a partner/s from outside East Asia.

Source: Compiled from ADB FTA Database; *Asia Regional Integration Center* (aric.adb.org); 31 October 2007.

**Table 6: Scope of Concluded FTAs in East Asia, 2001 and 2007 (cumulative FTAs)**

Scope of FTAs <sup>1</sup>	No. of Concluded FTAs		By Configuration <sup>2</sup> (October 2007)	
	Dec. 2001	Oct. 2007	Bilateral	Plurilateral
Goods	3	8 <sup>6</sup>	4	4
Goods + Services	0	3 <sup>7</sup>	2	1
Goods + Services + Singapore Issues <sup>3</sup>	2	9 <sup>8</sup>	7	2
Goods + Services + Singapore Issues + Cooperation Enhancement <sup>4</sup>	0	15 <sup>9</sup>	14	1
<b>Total</b>	<b>5</b>	<b>35<sup>5</sup></b>	<b>27<sup>5</sup></b>	<b>8</b>

Notes:

<sup>1</sup> Refers to FTA provisions

<sup>2</sup> Bilateral FTAs involve only two parties, while plurilateral FTAs involve more than two parties (for example, ASEAN).

<sup>3</sup> Singapore issues include trade facilitation, investment, government procurement, and competition policy.

<sup>4</sup> Cooperation enhancement includes provisions on environment, e-commerce, information exchange, SMEs, and labor standards.

<sup>5</sup> Does not include Taipei,China-Nicaragua FTA and Taipei,China-El Salvador-Honduras FTA due to difficulty in accessing the official text of agreements.

<sup>6</sup> Asia-Pacific Trade Agreement (1976), Laos-Thailand Preferential Trading Arrangement (1991), ASEAN Free Trade Agreement (1993), PRC-Thailand Free Trade Agreement (2003), ASEAN-Korea Free Trade Agreement (2006), PRC Chile Free Trade Agreement (2006), PRC-Pakistan Free Trade Agreement (2006), and Preferential Tariff Arrangement Group of Eight Developing Countries (2006).

<sup>7</sup> PRC-Hong Kong, China Closer Economic Partnership Arrangement (2004), PRC-Macao Closer Economic Partnership Arrangement (2004), and ASEAN-PRC Free Trade Agreement (2005).

<sup>8</sup> Singapore-European Free Trade Association (EFTA) Free Trade Agreement (2001), Singapore-New Zealand Closer Economic Partnership Agreement (2001), Korea-Chile Free Trade Agreement (2004), Taipei,China-Panama Free Trade Agreement (2004), Korea-European Free Trade Association (EFTA) Free Trade Agreement (2005), Singapore-India Comprehensive Economic Cooperation Agreement (2005), Japan-Malaysia Economic Partnership Agreement (2006), Taipei,China-Guatemala Free Trade Agreement (2006) and Japan-Chile Strategic Economic Partnership Agreement (2007).

<sup>9</sup> Japan-Singapore Economic Agreement for a New-Age Partnership (2002), Singapore-Australia Free Trade Agreement (2003), Singapore-United States Free Trade Agreement (2004), Japan-Mexico Economic Partnership Agreement (2005), Singapore-Jordan Free Trade Agreement (2005), Thailand-Australia Free Trade Agreement (2005), Thailand-New Zealand Closer Economic Partnership Agreement (2005), Japan-Philippines Economic Partnership Agreement (2006), Korea-Singapore Free Trade Agreement (2006), Singapore-Panama Free Trade Agreement (2006), Trans-Pacific Strategic Economic Partnership Agreement (2006), Japan-Thailand Economic Partnership Agreement (2007), Japan-Brunei Economic Partnership Agreement (2007), Korea-United States Free Trade Agreement (2007), and Japan-Indonesia Economic Partnership Agreement (2007).

**Table 7: Coverage of Selected “WTO Plus” East Asian FTAs, 2007**

Provisions	Japan-Singapore EPA (2002)	Japan-Mexico EPA (2005)	Japan-Philippines EPA (2006)	Japan-Thailand EPA (2007)	Japan-Brunei EPA (2007)	Japan-Indonesia EPA (2007)	Korea-US FTA (2007)	US-Singapore FTA (2004)	Singapore-Australia FTA (2003)	Thailand -Australia CER FTA (2005)	Thailand -New Zealand CEPA (2005)	Korea-Singapore FTA (2006)	Singapore-Jordan FTA (2005)	Singapore-Panama FTA (2006)	Transpacific Strategic EPA (2006)
<b>A) GOODS</b>															
Tariff Elimination	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Rules of Origin (ROO)	X	X	X	X	X	X	X	X	X	X		X	X	X	X
Trade Remedies -Anti Dumping				X	X	X	X					X	X	X	X
Trade Remedies -Subsidies & Countervailing				X	X	X	X					X	X	X	X
Trade Remedies -Bilateral Safeguards	X	X	X	X	X	X	X	X				X	X	X	X
Tariff Rate Quotas															
Early Harvest Program															
Agriculture covered	X	X	X	X	X	X	X								
Textiles and Apparel	X		X	X	X	X	X	X							
Quarantine and SPS Measures		X					X		X	X	X	X			
Other NTBs non-tariff barriers	X		X	X	X		X						X	X	X
Technical Barriers to Trade	X		X				X	X	X	X	X	X		X	X
Standards and Conformance, Mutual Recognition	X	X	X	X			X	X		X	X	X		X	X
Customs Administration and Procedures				X	X	X	X		X	X	X			X	
Paperless trading	X		X	X					X			X		X	X
<b>B) SERVICES</b>															
Telecommunications	X	X	X	X		X	X	X	X			X	X	X	
Financial Services	X	X	X	X		X	X	X	X			X	X	X	X
Professional Services						X	X					X			
Labor Mobility/Temporary Entry of Business Persons	X	X	X	X	X	X	X	X	X	X	X	X		X	X
<b>C) SINGAPORE ISSUES</b>															
Trade Facilitation	X	X	X	X	X		X	X	X		X	X			X
Investment	X	X	X	X	X	X	X	X	X	X	X	X		X	X
Government Procurement	X	X	X	X	X	X	X	X	X	X	X	X		X	X
Competition Policy	X	X	X	X		X	X	X	X	X	X	X		X	X
<b>D) COOPERATION ENHANCEMENT</b>															
Intellectual Property	X	X	X	X	X	X	X	X	X	X	X	X			X
E-Commerce							X	X	X	X		X	X		
Labor Standards/ Movement of Natural Persons	X		X	X	X	X	X	X			X		X		X
Environment		X	X	X	X	X	X	X			X	X			X
ECOTECH	X	X	X	X	X				X			X		X	X
Strategic Partnership						X								X	X
Capacity Building					X	X									
Information Exchange				X	X	X									
Energy				X	X	X						X			
Transport and Communications	X	X	X	X	X		X					X	X	X	
Construction	X	X	X									X			
SME	X		X	X	X										
Trade and Investment Promotion				X	X	X	X							X	
Transparency				X	X	X	X	X		X	X	X	X	X	X
State Trading Enterprises															
Education				X	X				X						
<b>E) DISPUTE SETTLEMENT</b>															
% of goods and services provisions covered (A+B)	68	53	68	79	68	68	89	53	47	53	37	74	42	74	68
% of WTO Plus provisions covered (C+D)	50	45	55	75	75	60	55	45	40	30	40	60	15	45	50

Note: X = Provision included in FTA.

Source: Compiled from ADB FTA Database and official documents; data as of 31 October 2007.

**Table 8: Rules of Origin of Selected Concluded FTAs in East Asia, 2007**

Agreement	Notes	Compared with AFTA (40%) VA rule
<b>Value-Added Content (VC) Rule only (3 FTAs)</b>		
1 Singapore-New Zealand Closer Economic Partnership Agreement (2001)	At least <b>40%</b> of the cost is of New Zealand or Singapore origin, and the last place of manufacture is in New Zealand or Singapore.	consistent
2 Singapore-Australia Free Trade Agreement (2003)	For manufactured products: (a) Local value-added content (VC) of <b>50%</b> or (b) VC of <b>30%</b> for 114 tariff subheadings. These include electrical & electronic equipment and precision instruments.	some products more/less restrictive
3 Singapore-Jordan Free Trade Agreement (2005)	All products, <u>with the exception of textile and apparel goods</u> , need only fulfill a general rule of origin of a relatively low threshold of <b>35%</b> local VC. For textile and apparel goods, specific process rules apply.	less restrictive
<b>VC and/or Change of Tariff Classification (CTC) Rules (3 FTAs)</b>		
1 Taipei, China-Panama Free Trade Agreement (2004)	Regional VC requirement: <b>35%</b> , <b>40%</b> , <b>45%</b>	some products more/less restrictive
2 Thailand-New Zealand Closer Economic Partnership Agreement (2005)	Regional VC requirement: <b>50%</b>	more restrictive
3 PRC-Chile Free Trade Agreement (2006)	Regional VC requirement: <b>40%</b> or <b>50%</b>	some products more restrictive
<b>VC and/or Specific Product (SP) Rules (4 FTAs)</b>		
1 Asia-Pacific Trade Agreement (1976)	Regional VC requirement: <b>45%</b> for most products. <u>Special Criteria Percentage</u> : Products originating in Least Developed Participating States can be allowed a favorable 10 percentage points applied to the percentages established in Rules 3 and 4 of APTA.	more restrictive
2 ASEAN Free Trade Agreement (1993)	Local or regional VC of <b>40%</b> or product specific rule for the following sectors: (a) Process criterion for textiles and textile products; (b) Change in chapter rule for wheat flour; (c) CTC for wood-based products; (d) CTC for certain aluminum and articles thereof.	consistent
3 ASEAN-PRC Free Trade Agreement (2005)	Regional or local VC of <b>40%</b> or product specific rule. Process criterion required for textiles and textile products.	consistent

4	PRC-Pakistan Free Trade Agreement (2006)	Regional VC requirement: <b>40%</b>	consistent
<b>Combination of all Rules (VC, CTC, SP, others) (21 FTAs – Selected Examples Shown)</b>			
1	Japan-Singapore Economic Agreement for a New-Age Partnership (2002)	For manufactured products, change in tariff heading (CTH) for all imported inputs used in the manufacture of the product; Singapore must be the place where the last substantial manufacture takes place. Additional flexibility for 264 products; CTH or local value-added content (VC*) of <b>60%</b> .	more restrictive
2	Singapore-United States Free Trade Agreement (2004)	For manufactured products, (a) CTC for all imported inputs used in the manufacture of the product; Singapore must be the place where the last substantial manufacture takes place; (b) Regional value-added content (VC*) of <b>35-60%</b> (applies mainly to electronic products); (c) Process rule (applies mainly to chemicals and petrochemicals).	some products more/less restrictive
3	Korea-European Free Trade Association (EFTA) Free Trade Agreement (2005)	Regional VC requirement: <b>25%, 30%, 45%, 50%, or 60%</b>	some products more/less restrictive
4	Singapore-India Comprehensive Economic Cooperation Agreement (2005)	Local VC requirement: <b>40%</b>	consistent
5	Japan-Mexico Economic Partnership Agreement (2005)	Regional or local VC requirement: <b>50%, 65%, or 70%</b>	more restrictive
6	Thailand-Australia Free Trade Agreement (2005)	Regional VC requirement: <b>40-45 or 55%</b>	some products more restrictive
7	ASEAN-Korea Free Trade Agreement (2006)	Regional VC requirement: <b>40%, 50%, or 60%</b> . Specific manufacturing process for textiles and garments.	some products more restrictive
8	Trans-Pacific Strategic Economic Partnership Agreement (2006)	A product will qualify for preferential treatment if (a) it meets the specific rule of origin applicable to it (in many cases, this is a liberal CTH rule) or (b) where so stipulated, if at least <b>45%</b> of the cost originates from the party.	more restrictive
9	Korea-Singapore Free Trade Agreement (2006)	Regional VC requirement: <b>55%</b>	more restrictive
10	Japan-Thailand Economic Partnership Agreement (2007)	Regional VC requirement: <b>40%</b>	consistent
11	Korea-United States Free Trade Agreement (2007)	Regional VC requirement: <b>35/45%, 40/50%, 55%</b> (build-up/build-down method)	some products more/less restrictive

**Table 9: Rules of Origin for Major Auto and Auto Parts Products in Selected East Asian FTAs**

FTA	HS Code	Product Description	Japan		Korea, Rep. Of		China, People's Rep. Of		ASEAN		Singapore		Thailand	
			Japan-Malaysia EPA (2006)	Japan-Singapore EPA (2002)	Japan-Thailand EPA (2007)	Korea-Singapore FTA (2006)	PRC-Pakistan FTA (2006)	ASEAN Free Trade Area (1993)	ASEAN-PRC FTA (2005)	ASEAN-Korea FTA (2006)	Singapore-Australia FTA (2003)	Singapore-FTA (2004)	United States-Singapore FTA (2004)	Thailand-Australia FTA (2005)
	87.01	Tractors (other than works, warehouse equipment)	CTC (6 digit) or RVC of 40%	CTC; last substantial manufacture*	CTC or RVC of 40%	CTC plus RVC of 55%	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%* or a CTC (4 digits)*	VC of not less than 50%*	CTC plus RVC of at least 30% (build up)	CTC plus RVC of 40%	
	87.03	Motor vehicles for transport of persons (except buses)	CTC or RVC of 60%	CTC; last substantial manufacture*	CTC or RVC of 40%	CTC plus RVC of 55%	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%*	RVC of 45%	Last process of manufacture within territory of the party	CTC plus RVC of at least 30% (build up)	CTC plus RVC of 40%	
	87.04	Motor vehicles for the transport of goods	CTC or RVC of 50%	CTC; last substantial manufacture*	CTC or RVC of 40%	CTC plus RVC of 55%	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%*	RVC of 45%	VC of not less than 50%*	CTC plus RVC of at least 30% (build up)	CTC plus RVC of 40%	
	87.08	Parts and accessories for motor vehicles	CTC or RVC of 60%	CTC; last substantial manufacture*	CTC or RVC of 40%	CTC plus RVC of 50%/55%	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%*	RVC of 45%	Last process of manufacture within territory of the party	CTC (6 digit) or CTC plus RVC of at least 30% (build up)	CTC (6 digit) plus RVC of 40%	
	87.11	Motorcycles, bicycles, etc. with auxiliary motor	CTC or RVC of 60%	CTC; last substantial manufacture*	CTC or RVC of 40%	CTC plus RVC of 55%	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%* or a CTC (4 digits)*	VC of not less than 50%*	CTC (4 digit) or CTC plus RVC of at least 30% (build up)	CTC (6 digit) and/or RVC of 40%	
	87.14	Parts and accessories of bicycles, motorcycles, etc.	CTC or RVC of 40%	CTC; last substantial manufacture*	CTC or RVC of 40%	CTC (4 digit)	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%*	RVC of not less than 40%* or a CTC (4 digits)*	VC of not less than 50%*	CTC (6 digit) or CTC plus RVC of at least 30% (build up)	CTC (6 digit)	

Notes: The general rules of origin of the FTA are adopted when there is no Specific Product (SP) rule provided. CTC=Change of Tariff Classification; RVC=Regional Value-added Content; VC= Value-added Content.  
Source: Authors' compilation.



**Table 10: Indicators of Openness and Market Orientation, 2005**

<b>Economy</b>	<b>Average Import Tariff Rates<sup>1</sup></b> (Manufactures, in %)	<b>Time for Import</b> (No. of days)	<b>Time to Start a Business</b> (No. of days)
Japan	3.49	11	23
Korea, Rep. of	7.23	12	22
China, People's Rep. of	10.36	22	35
India	15.67	41	35
Australia	4.20	12	2
New Zealand	4.22	13	12
Brunei Darussalam	5.42	...	...
Cambodia	17.11	45	86
Indonesia	10.10	30	97
Lao People's Democratic Republic	9.88	78	163
Malaysia	11.53	22	30
Myanmar	5.64	...	...
Philippines	7.10	20	48
Singapore	0.00	3	6
Thailand	10.59	22	33
Viet Nam	17.92	36	50
<b>Average for ASEAN</b>	<b>9.53</b>	<b>32</b>	<b>64<sup>2</sup></b>

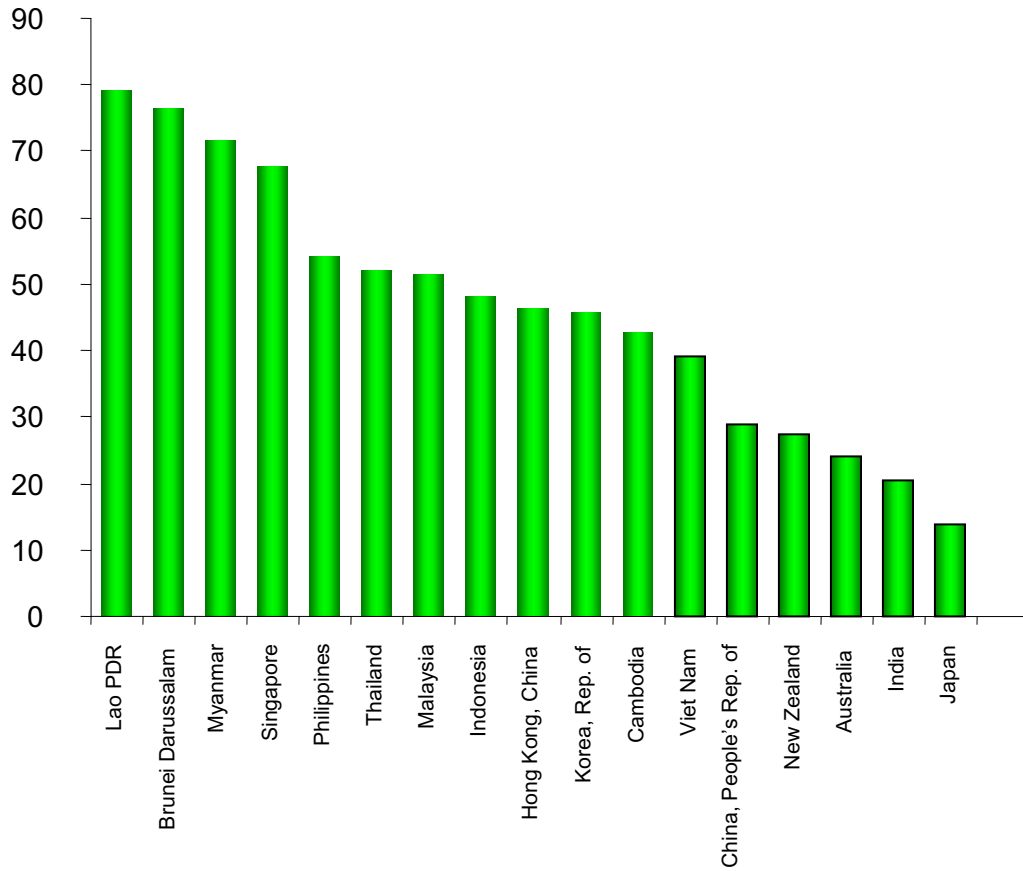
Notes:

<sup>1</sup> MFN rate; data as of 2005 except for Korea (2004) and Cambodia (2003).

<sup>2</sup> Average for ASEAN excluding Lao PDR is 50.

Sources: Compiled from UNCTAD and World Bank.

**Figure 1: Share of an Economy's Trade with FTA Partners\*  
Relative to the Economy's Total Global Trade, 2006 (%)**



\* Covers concluded FTAs only.  
Source: IMF Direction of Trade Statistics.

## Appendix 1: Computable General Equilibrium Analysis of East Asian FTA Scenarios

A growing body of empirical literature has been developed on the impact of prospective FTAs on East Asian economies using computable general equilibrium (CGE) models in response to advances in CGE models and policy interest alternative FTA arrangements. This literature includes contributions by Urata and Kiyota (2003); Mohanty, Pohit and Roy (2004), Glibert *et al.* (2004), Cheong (2005), Bchir and Fouquin (2006), Plummer and Wignaraja (2006) and Zhang *et al.* (2006). These studies commonly use the Global Trade Analysis Project (GTAP) database but vary in the underlying model and behavior of agents, the policy scenarios analyzed and the version of the database used.<sup>31</sup> While there has been some CGE work on an ASEAN+3 FTA and other alternatives, only limited work is available on the effects of an ASEAN+6 FTA or a comparison between an ASEAN+3 and an ASEAN+6 FTA. Furthermore, such work tends to narrowly focus on an FTA involving goods only, while other aspects of the coverage of East Asian FTAs (for example, services and trade costs) are excluded. There is a need for a more comprehensive set of CGE estimates on East Asian FTAs to fill these gaps.

Accordingly, a CGE exercise was undertaken by ADB using a variant of the GTAP model.<sup>32</sup> The model is characterized by an input-output structure (based on regional and national input-output tables) that explicitly links industries in a value-added chain from primary goods, over continuously higher stages of intermediate processing, to the final assembling of goods and services for consumption. Inter-sectoral links are both direct, like the input of steel in the production of transport equipment, and indirect, via intermediate use in other sectors. The model captures these links by modeling firms' use of factors and intermediate inputs. The key aspects of the model are: (i) it covers world trade and production; (ii) it includes intermediate linkages between sectors; (iii) and it allows for trade to affect capital stocks through investment activities. The final point means that medium- to long-run investment effects are captured in the model.

The main database used is the GTAP dataset version 6.3 which included detailed national input-output, trade and final demand structures. This database was projected through to 2017 trade and production patterns to represent a post-Uruguay Round world. The coverage of FTA provisions is a stylized FTA that includes goods, services and some aspects of trade cost reduction. Hence, the analysis includes the impact of regional tariff elimination for goods, liberalization of services trade, and trade facilitation including improved trade-related infrastructure. Forward projection of the database and extending the coverage of FTAs beyond goods are recent developments in the CGE FTA studies.

Based on the above CGE framework, five East Asian FTA scenarios are considered:

1. An ASEAN+PRC FTA: free trade among the 10 ASEAN members, and PRC.
2. An ASEAN+Korea FTA: free trade among the 10 ASEAN members, and Korea.

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<sup>31</sup> For a review of East Asian FTA studies, see Kawai and Wignaraja (2007).

<sup>32</sup> The CGE estimates for the ASEAN+3 FTA scenario reported in this paper draw on a modeling exercise for an ADB project "Study on Economic Cooperation between East Asia and South Asia." The ASEAN+6 scenario was specifically computed for this paper. For more details of the CGE model used, see Francois and Wignaraja (2007).

3. An ASEAN+Japan FTA: free trade among the 10 ASEAN members, and Japan.
4. An ASEAN+3 FTA scenario: free trade among the 10 ASEAN members, PRC, Japan and Korea;
5. An ASEAN+6 FTA scenario: free trade among the 10 ASEAN members, PRC, Japan, Korea, India, Australia and New Zealand.

The five scenarios selected represent an illustrative range of FTA possibilities in East Asia. Scenarios 1–3 are FTAs between ASEAN and each of Northeast Asian countries. Scenarios 1 and 2 have been concluded while Scenario 3 is under negotiation (see Appendix Table 2). Scenarios 4 and 5 represent on-going discussions among policymakers on region-wide FTAs. Based on bridging ASEAN and the region's Northeast Asian neighbors, scenario 4 was an early attempt at an East Asia-wide FTA. Scenario 5 has emerged with the realization that the synergies could be gained by linking Australia-New Zealand and India with ASEAN+3.

Table A1 below shows the estimated impacts on national income of the FTA scenarios. The two East Asia-wide FTA scenarios—ASEAN+3 FTA and ASEAN+6 FTA—offer larger gains to world income than any of the three ASEAN+1 FTA scenarios. The ASEAN+6 FTA scenario—which is broader in terms of country coverage—offers the larger gains to world income (\$260 billion, measured in constant 2001 prices) than the ASEAN+3 FTA scenario (\$214 billion). Looking separately at the ASEAN+1 scenarios, the ASEAN+PRC FTA scenario indicates larger gains (\$82 billion) to world income than the other two ASEAN+1 scenarios.

A breakdown of the world income figure for the ASEAN+6 FTA scenario indicates that the gains to members of the FTAs are significant (\$285 billion) while the losses to non-members are relatively small (\$25 billion). Similarly, in the ASEAN+3 scenario, the gains for members are large at \$228 billion while losses to non-members are only \$14 billion. Hence, insiders gain and outsiders lose relatively little from the formation of an ASEAN+3 or an ASEAN+6 FTA.

The ASEAN+3 and ASEAN+6 FTA scenarios have different impacts on regions and countries. The three Northeast Asian economies (members of all proposed FTAs) are expected to see the largest gains under the ASEAN+3 FTA (\$166 billion) and the ASEAN+6 FTA (\$172 billion).<sup>33</sup> The ASEAN economies (also members of the proposed FTAs) experience the largest gains from the ASEAN+PRC FTA (\$44 billion) among the three ASEAN+1 FTAs and obtain further gains from the ASEAN+3 FTA (\$62 billion) and the ASEAN+6 FTA (\$67 billion). The projected gains for ASEAN members as a percent change from 2017 baseline income are substantial under the ASEAN+6 scenario—Thailand (12.8%), Viet Nam (7.6%), Malaysia (6.3%) and Singapore (5.4%). Among the Northeast Asian countries, Korea (6.4 %) experiences larger gains than Japan or PRC.

India, Australia, and New Zealand either experience gains or losses depending on whether an ASEAN+3 FTA or an ASEAN+6 FTA is formed. They experience losses in the ASEAN+3 scenario and gains in the ASEAN+6 scenario. Under the ASEAN+6 scenario, the projected gains as a percent change from 2017 baseline income are 2.4% for India, 3.9% for Australia and 5.2% for New Zealand.

<sup>33</sup> Our findings confirm those of previous CGE studies that under an ASEAN+3 scenario Northeast Asian economies and ASEAN gain significantly. For instance, Zhang *et.al.* (2006) report gains of \$67 billion for Japan, f Korea and PRC and \$38 billion for ASEAN economies. Cheong (2005) finds gains of \$42 billion for the three Northeast Asian economies and \$20 billion for ASEAN.

The impact of the ASEAN+3 or ASEAN+6 FTA on third parties is limited with a few exceptions (like Taipei,China). There are small losses (typically less than 1 % change from 2017 baseline income) for the rest of South Asia, the rest of Oceania, Central Asia as well as the US and Russia. Meanwhile, there are small gains for the EU, Canada, Mexico and Sub-Saharan Africa.

The estimated wage effects for unskilled workers (see Table A2) are a rough measure of the distributional impact of the FTA scenarios. These are somewhat related to the income gains for members under the alternative scenarios. In the ASEAN+6 scenario, Thailand, Korea, Viet Nam, Singapore and Malaysia—with relatively large income effects—experience relatively large unskilled wage increases (between 5 % to 12%). Several other countries (for example, Japan, the PRC, Indonesia, Philippines, and India)—with relatively smaller income effects—witness unskilled wage increases of under 2%. Unexpectedly, however, Cambodia, Australia, and New Zealand see small declines in unskilled wages. Outsiders to the agreements, however, experience small declines in unskilled wages.

CGE simulation studies are useful in quantifying income effects of eliminating import tariffs on goods trade and liberalizing cross-border trade in services through the formation of an FTA. As they are unable to incorporate rules of origin and non-tariff measures (for example, TBT) which may afford more protection for domestic industries than tariffs, CGE studies are best when combined with analysis of the complex structure of FTAs and enterprise perception studies of the benefits of FTAs.<sup>34</sup>

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<sup>34</sup> See Francois, McQueen and Wignaraja (2005) and Piermartini and Teh (2005).

**Table A1: Income Effects of Alternative Scenarios**

Compared to 2017 baseline (at constant 2001 \$)

	ASEAN+PRC FTA		ASEAN+Japan FTA		ASEAN+Korea FTA		ASEAN+3 FTA <sup>1</sup>		ASEAN+6 FTA <sup>2</sup>	
	Value (\$ million)	% change	Value (\$ million)	% change	Value (\$ million)	% change	Value (\$ million)	% change	Value (\$ million)	% change
<b>Northeast Asia</b>	<b>9,756</b>	<b>0.11</b>	<b>18,624</b>	<b>0.21</b>	<b>7,256</b>	<b>0.08</b>	<b>165,720</b>	<b>1.85</b>	<b>172,087</b>	<b>1.93</b>
Japan	-3,965	-0.08	24,943	0.51	-1,308	-0.03	74,825	1.54	77,137	1.59
Korea, Republic of	-5,382	-0.67	-1,844	-0.23	10,916	1.37	49,393	6.19	51,351	6.43
People's Rep. of China	19,103	0.58	-4,475	-0.14	-2,351	-0.07	41,502	1.26	43,598	1.33
<b>ASEAN</b>	<b>44,211</b>	<b>3.72</b>	<b>28,831</b>	<b>2.43</b>	<b>8,088</b>	<b>0.68</b>	<b>62,186</b>	<b>5.23</b>	<b>67,206</b>	<b>5.66</b>
Cambodia	68	0.75	30	0.33	15	0.16	107	1.20	109	1.21
Indonesia	6,924	2.30	2,834	0.94	1,475	0.49	7,884	2.62	8,588	2.86
Malaysia	7,551	4.02	4,453	2.37	1,339	0.71	10,391	5.54	11,869	6.33
Philippines	2,556	2.13	1,915	1.59	630	0.52	3,177	2.64	3,431	2.85
Singapore	6,854	4.13	3,171	1.91	793	0.48	7,943	4.79	9,002	5.43
Thailand	16,324	7.39	14,107	6.39	2,640	1.20	26,728	12.10	28,346	12.84
Viet Nam	3,371	4.68	2,119	2.94	1,136	1.58	5,293	7.35	5,490	7.63
Others	563	0.50	203	0.18	60	0.05	661	0.59	370	0.33
<b>Other East Asia</b>	<b>-2,676</b>	<b>-0.30</b>	<b>-1,124</b>	<b>-0.13</b>	<b>-528</b>	<b>-0.06</b>	<b>-11,649</b>	<b>-1.32</b>	<b>-13,530</b>	<b>-1.54</b>
Hong Kong, China	-112	-0.03	-68	-0.02	-73	-0.02	-1,051	-0.33	-1,900	-0.59
Taipei,China	-2,519	-0.49	-1,093	-0.21	-443	-0.09	-10,493	-2.03	-11,527	-2.23
Others	-44	-0.11	38	0.09	-12	-0.03	-105	-0.25	-102	-0.24
<b>South Asia</b>	<b>-1,059</b>	<b>-0.09</b>	<b>-823</b>	<b>-0.07</b>	<b>-530</b>	<b>-0.05</b>	<b>-3,620</b>	<b>-0.32</b>	<b>17,193</b>	<b>1.52</b>
Bangladesh	-85	-0.08	-62	-0.06	-47	-0.04	-297	-0.26	-418	-0.37
India	-809	-0.10	-658	-0.08	-370	-0.05	-2,371	-0.30	19,270	2.42
Pakistan	-162	-0.11	-83	-0.06	-86	-0.06	-824	-0.55	-1,179	-0.79
Sri Lanka	-21	-0.07	-15	-0.05	-22	-0.07	-117	-0.38	-209	-0.67
Others	19	0.05	-4	-0.01	-5	-0.01	-12	-0.03	-271	-0.73
<b>Oceania</b>	<b>1,326</b>	<b>0.20</b>	<b>-1,272</b>	<b>-0.19</b>	<b>-26</b>	<b>0.00</b>	<b>-2,600</b>	<b>-0.38</b>	<b>26,385</b>	<b>3.88</b>
Australia	1,046	0.18	-1,204	-0.21	-9	0.00	-2,376	-0.41	22,546	3.91
New Zealand	166	0.21	-73	-0.09	12	0.02	-216	-0.27	4,136	5.24
Others	114	0.48	5	0.02	-28	-0.12	-8	-0.03	-296	-1.25

<b>Central Asia</b>	<b>70</b>	<b>0.04</b>	<b>-41</b>	<b>-0.02</b>	<b>-26</b>	<b>-0.01</b>	<b>-159</b>	<b>-0.09</b>	<b>-205</b>	<b>-0.11</b>
<b>NAFTA</b>	<b>9,985</b>	<b>0.06</b>	<b>-214</b>	<b>0.00</b>	<b>273</b>	<b>0.00</b>	<b>-235</b>	<b>0.00</b>	<b>-4,474</b>	<b>-0.03</b>
Canada	1,211	0.12	363	0.04	155	0.02	1,796	0.18	1,546	0.15
United States	7,713	0.05	-782	-0.01	287	0.00	-4,966	-0.03	-8,917	-0.06
Mexico	1,062	0.11	205	0.02	-169	-0.02	2,935	0.31	2,897	0.30
<b>Latin America</b>	<b>2,667</b>	<b>0.13</b>	<b>-109</b>	<b>-0.01</b>	<b>-303</b>	<b>-0.01</b>	<b>-2,082</b>	<b>-0.10</b>	<b>-2,958</b>	<b>-0.14</b>
<b>EU27</b>	<b>12,921</b>	<b>0.11</b>	<b>867</b>	<b>0.01</b>	<b>253</b>	<b>0.00</b>	<b>6,786</b>	<b>0.06</b>	<b>1,806</b>	<b>0.02</b>
<b>Sub-Saharan Africa</b>	<b>604</b>	<b>0.15</b>	<b>68</b>	<b>0.02</b>	<b>8</b>	<b>0.00</b>	<b>396</b>	<b>0.10</b>	<b>457</b>	<b>0.12</b>
<b>Rest of the World</b>	<b>4,193</b>	<b>0.13</b>	<b>326</b>	<b>0.01</b>	<b>-292</b>	<b>-0.01</b>	<b>-824</b>	<b>-0.03</b>	<b>-4,130</b>	<b>-0.13</b>
EFTA	874	0.17	193	0.04	94	0.02	1,089	0.21	1,074	0.21
Turkey	-17	-0.01	-90	-0.03	-143	-0.05	-538	-0.19	-713	-0.25
Russia	438	0.09	135	0.03	75	0.01	-197	-0.04	-333	-0.07
Other Europe	-36	-0.04	-19	-0.02	-21	-0.02	-52	-0.06	-85	-0.10
North Africa & Middle East	2,761	0.17	119	0.01	-299	-0.02	-1,083	-0.07	-3,549	-0.22
South Africa	172	0.10	-13	-0.01	1	0.00	-44	-0.03	-524	-0.32
<b>World</b>	<b>81,998</b>	<b>0.17</b>	<b>45,134</b>	<b>0.09</b>	<b>14,173</b>	<b>0.03</b>	<b>213,919</b>	<b>0.45</b>	<b>259,837</b>	<b>0.54</b>

Notes:

<sup>1</sup> ASEAN+3 includes the 10 ASEAN members (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam) plus People's Republic of China, Japan, and Republic of Korea.

<sup>2</sup> ASEAN+6 includes ASEAN+3 countries, Australia, India, and New Zealand.  
Source: ADB estimates.

**Table A2: Unskilled Workers' Wage Effects of FTA Scenarios**  
 % change compared with 2017 baseline (at constant 2001 \$)

	ASEAN+3 FTA <sup>/a</sup>	ASEAN+6 FTA <sup>/b</sup>
<b>Northeast Asia</b>		
Japan	1.79	1.77
Korea, Rep. of	9.33	9.26
China, People's Rep. of	1.83	1.80
<b>ASEAN</b>		
Cambodia	-1.07	-1.14
Indonesia	1.67	1.53
Malaysia	4.91	5.00
Philippines	0.65	0.69
Singapore	4.64	5.58
Thailand	11.07	11.95
Viet Nam	7.96	8.24
Others	-0.53	-1.41
<b>Other East Asia</b>		
Hong Kong, China	-0.62	-0.64
Taipei, China	-1.97	-2.02
Others	-0.44	-0.46
<b>South Asia</b>		
Bangladesh	0.44	0.97
India	-0.19	1.66
Pakistan	-0.15	-0.25
Sri Lanka	-0.26	0.52
Others	0.00	-2.47
<b>Oceania</b>		
Australia	-0.69	-0.74
New Zealand	-0.60	-0.60
Others	-0.49	-0.50

Notes:

<sup>/a</sup> ASEAN+3 includes ASEAN members, People's Republic of China, Japan, and Republic of Korea.

<sup>/b</sup> ASEAN+6 includes ASEAN+3 countries, Australia, India, and New Zealand.

Source: ADB estimates.