

Phase II Report of the Track Two Study Group on Comprehensive Economic Partnership in East Asia (CEPEA)

3 July 2009

Preface

At the third East Asia Summit (EAS) held on 21 November, 2007 in Singapore, the Leaders of ASEAN, Australia, the People's Republic of China, the Republic of India, Japan, the Republic of Korea, and New Zealand, welcomed the progress report by Track Two Study Group on Comprehensive Economic Partnership in East Asia (CEPEA) and encouraged the Group to work towards submitting a report of recommendations to the Leaders through Economic Ministers.

At the AEM+6 Working Lunch in August 2008, Economic Ministers noted the Report and agreed to convey the Report to the Leaders at the 4th EAS. They also agreed to Phase II Track Two Study on CEPEA, detailing the pillars of economic cooperation, facilitation and liberalization as well as institutional developments.

The Study Group began its Phase II Study in November 2008 to reply Ministers' instruction and held four meetings for completion of this report.

The Study Group has conducted discussions based on the Minister's instructions and related inputs submitted by the experts. Additionally, the experts noted the impact of economic crisis to East Asian economies and exchanged their view on the role of economic integration of CEPEA under this difficult circumstance.

It is our pleasure to present this report to EAS Economic Ministers and the Leaders.

Risaburo Nezu

Chairman

Track Two Study Group

on Comprehensive Economic Partnership in East Asia (CEPEA)

3 July 2009

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Dates and Places of the Meetings of the Study Group

28 November, 2008

Tokyo, Japan

14 March, 2009

Auckland, New Zealand

30 May, 2009

Sydney, Australia

3 July, 2009

Jakarta, Indonesia

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I. Executive Summary

Executive Summary of the Phase II Report of the Track Two Study Group on Comprehensive Economic Partnership in East Asia (CEPEA)

1. Introduction

1. The Track Two Study Group on a Comprehensive Economic Partnership in East Asia (CEPEA) released its Phase I report in 2008 on the desirability of further regional integration among East Asia Summit (EAS) countries. The report set out CEPEA's objectives as deepening economic integration, narrowing development gaps, and achieving sustainable development. It was also affirmed that CEPEA would be composed of three pillars, namely economic cooperation, facilitation of trade and investment, and liberalization of trade and investment. The report was submitted to the Economic Ministers of EAS countries (AEM+6) in August 2008. At the meeting, Ministers noted the report and agreed to a Phase II Track Two Study on CEPEA detailing the pillars of economic cooperation, facilitation and liberalization, as well as institutional developments. Following the Ministers' agreement, the study has been carried out, with four meetings being held between November 2008 and July 2009. This report summarizes the discussions among the CEPEA experts and their written contributions.

2. Developments since the Last Report of June 2008

2. The worldwide financial and economic crises that originated in the US financial sector caused serious economic impact to the EAS countries, in spite of the fact that Asian economies were not as exposed to excessive leveraging or risky financial assets as the US or European economies. This phenomenon brought to light some risk factors associated with high dependence on external markets and concentration on a narrow range of industrial sectors. In light of the long-term prospect that the US will have to reduce its external deficit, Asian countries must rectify this situation if they are to be more resilient in response to abrupt external shocks. Promoting demand within the region and establishing unfettered intra-regional trade to complement trade beyond the region should be one of the key strategies for achieving this goal.
3. In response to this sharply deteriorating world economy, the Leaders of G20 met in November 2008 and April 2009 and agreed to take united and concerted actions. Six EAS countries - Australia, China, India, Indonesia, Japan and Korea - were represented at the meeting. Thailand, as Chair of ASEAN for the year 2009, also participated in the April meeting. This is a reflection of the growing importance of EAS countries in the global community.
4. In March 2009, the Leaders of ASEAN recognized the efforts to promote financial sector cooperation in various ASEAN-led fora including ASEAN+1, ASEAN+3 and EAS. The

Leaders also underscored the importance and urgency of the strengthening of Chiang Mai Initiative (CMI), which is a framework of mutual assistance among ASEAN+3 countries. An important achievement was made at the ASEAN+3 Finance Ministers Meeting on May 3, 2009, where thirteen member countries have reached agreement on all the main components of the CMI, including individual countries' contributions, borrowing accessibility, and the surveillance mechanism. In addition, ASEAN+3 and EAS Leaders expressed their commitment to global and regional financial cooperation in June 2009,.

5. CEPEA provides a vehicle to transform the economic structures of member countries. This will be made possible if EAS countries can make improvements in the following three areas: first, to expand domestic demand within the region; second, to enhance overall economic efficiency through measures such as rational production specialization and strengthening production networks among the member countries; and third, development of infrastructure that connects member countries. These developments will lead to the narrowing of development gaps in the region, as well as deepening integration. These three elements are directly related to the emerging consensus to rebalance economic growth in the region, which is considered to be the primary policy response to the 2008 economic crisis.
6. East Asia has developed a wide range of interdependent industries with tightly knit supply chains. But, continued development of a production network is necessary to raise the growth potential of industries to a higher level by achieving efficient resource allocation. At the same time, an effective social safety net should be established so that people can feel more comfortable about spending for a higher standard of living. EAS countries need to work together to ensure collective efforts and facilitate mutual learning through exchanges of information, peer reviews, and, wherever feasible, policy coordination.
7. In spite of the global economic crisis, the momentum in EAS countries toward FTA/EPAs has continued unabated. There have been important developments in the negotiation of FTA/EPAs. A number of FTA/EPAs have been successfully concluded and signed since the completion of the last report of the CEPEA Track Two Group. These agreements, together with the agreements that are already in effect, will help expand intra-regional trade and deepen economic integration.

3. Economic Cooperation

8. One of the goals of CEPEA is to narrow the development gaps among the sixteen member countries. There is a need for rigorous efforts by the entire group to mobilize financial, technological and human resources to accelerate the economic growth of less developed countries. The Track Two Study Group recommends cooperation projects that could start with capacity building in information gathering and research on development issues with a view to creating a level playing field for EAS countries. As CEPEA consists of countries at different stages of development with different industrial structures, cooperation projects should be designed to maximize the opportunities for recipient countries to achieve faster growth and sustainable development. Prioritization and a focussed approach are even more important in light of the limited availability of cooperation resources. Also, these projects should be built

on existing cooperative efforts in the region, rather than duplicating them or competing with one another.

9. Within the EAS region, a high number of cooperation projects have been undertaken and actually implemented, mostly on an ASEAN +1 bilateral basis. But under the present regime, it is far from clear to what extent they were coordinated with other projects and how they were followed up. CEPEA could help improve this situation and raise the overall effectiveness of the cooperation programs, if a sufficient flow of information is assured among members and the necessary coordination and evaluation of projects are realized. This could also contribute to avoiding the risk of unbalanced distribution of such resources.
10. Out of the above-mentioned categories, CEPEA Track Two experts identified certain priority areas where region-wide cooperation will be particularly useful. Human resource development, for example, is crucial in improving the quality of public policies. Cooperation programs under CEPEA may start with the training of government officials in such areas as administrative skills, and energy and resource management. Many other cooperation fields including technology transfer, ICT infrastructure, improvement of transport infrastructure/logistics, environment/energy, rural development and business environment for small and medium enterprises (SMEs) are also identified as areas where region-wide cooperation will be particularly useful.

4. Facilitation

11. In order to enhance the flow of goods, services, technology, knowledge, and people among EAS countries, a stable business environment governed by transparent, predictable, streamlined, and harmonized market rules plays a very important role. As many FTA/EPAs have been concluded in East Asia, differences among these agreements have become increasingly cumbersome to business. For instance, a variety of different procedures and document requirements for the issuance of certificates of origin add to the cost of compliance for exporters.
12. Rules of origin (ROO) issues are widely recognized as critical elements in ensuring that the gains from economic integration are not undermined by complex rules. At present, each FTA/EPA in the EAS region has varying ROOs, which potentially leads to the “spaghetti-bowl” phenomenon. While it was recognized that ROO could be used as a development tool, it was unanimously agreed that well-coordinated and streamlined ROO regimes would be in the interest of business enterprises in the EAS region. CEPEA could be the vehicle for pursuing harmonization and streamlining of the ROO regimes. As an initial step, work on ROO could focus on harmonization of procedures for the issuance of Certificates of Origin and for “self-certification”, and enhancing cumulation rules for effective utilization of FTA/EPAs that can contribute to the expansion of intra-regional trade among the EAS countries.
13. Electronic Customs clearance is identified as an area of huge potential benefit. If the Customs

of member countries are electronically linked and Customs information is shared, transaction costs can be dramatically reduced. In this respect, the approaches to establish a “Single Window” by both ASEAN and APEC would be quite profitable for EAS countries to realize an unimpeded trade environment within this region.

14. Product standards and conformity assessment measures on a region-wide basis are worth considering. This is an area where efforts of ASEAN countries began fairly recently and where other members of CEPEA might be able to assist ASEAN governments through sharing their experiences and providing of technical support and capacity building of the “soft infrastructure” for conformity assessment and compliance.
15. Facilitation measures under CEPEA should build on existing ASEAN initiatives. As ASEAN has played a key role as the driving force of economic integration in East Asia for years, it seems natural to utilize existing initiatives conducted by ASEAN. There should be no duplication with initiatives taken by other regional institutions such as ADB or APEC. If such initiatives are not sufficient, CEPEA should improve on their approach, rather than doing the same things in a competing fashion.
16. CEPEA could foster increased regional cooperation and capacity building support to deal with issues relating to domestic regulations such as intellectual property rights, government procurement, investment protection, and competition policy. These issues are considered sensitive by some EAS countries. But the Study Group as a whole considers that these matters should remain open for discussion. Such discussion should enable EAS countries to examine the potential benefits that could accrue for international domestic suppliers and the potential domestic providers, particularly in the less developed countries. Since some EAS countries have a very short history with these policies and their experience is limited, capacity building and human resource development for government officials should be given high priority.

5. Liberalization

17. The current economic crisis has reinforced the importance of expanding trade within the EAS region. Further liberalization is the essential step to achieve this objective, taking into account the special conditions prevailing in developing countries. A CGE analysis shows that liberalization in combination with cooperation and facilitation under the framework of CEPEA would produce considerable positive gains in terms of additional GDP for all EAS countries, particularly for developing countries.
18. Now that numerous sub-regional FTA/EPAs including ASEAN+1 FTA/EPAs are completed or nearly completed, EAS countries have reached the stage where they should begin considering how they can integrate individual agreements into a coherent and seamless free trade regime. However, in order to make meaningful progress in this direction, countries that are not yet connected by bilateral FTA/EPAs should step up their discussion as to how they can positively participate in the negotiations to reach a CEPEA-wide FTA/EPA. Establishing a region-wide FTA/EPAs, which covers all sixteen countries, will benefit the regional economy especially in

terms of reduced transaction costs that would be brought about by harmonized rules, including ROO regimes.

19. At present, the rates of utilization of existing FTA/EPAs are low. Resolving and ameliorating these technical and practical problems is urgently needed, and therefore should be given high priority under CEPEA.
20. One of the benefits generated by liberalization is the optimization of production and distribution systems on a region-wide scale. Analysis of the auto parts and automobile industries in ASEAN shows beneficial production specialization through relocations and centralizations.
21. The effects of FTA/EPAs on foreign direct investment (FDI) and exports are also significant. FDI into ASEAN10 has increased, and exceeded FDI into China in 2006. Such a sharp increase in inward FDI has helped expand production capacities in the recipient countries. In fact, ASEAN's exports show much higher growth than in Japan. Generally speaking, the relationship between trade liberalization and the flow of FDI is not always clear-cut. However, from the analyses of the regional production network and value-chain of the automobile industry, the conclusion can be drawn that trade liberalization induces increase of FDI. Similar effect can be expected from CEPEA.
22. CEPEA Track Two experts also identified the need for further research of the potential benefits of cooperation in movement of natural persons within the region for both higher-skilled and lower-skilled workers.

6. Institutional Development

23. A number of proposals were made to strengthen integration among EAS countries. But, in order to move from the stage of proposal to specific actions, concrete steps must be laid out and agreed upon among government officials who are responsible for the matters in question. Furthermore, there is a need for some mechanism for monitoring and follow-up implementations by individual governments of those agreed actions. These policy measures must be reviewed and evaluated periodically among the officials representing EAS countries, as the effects of these measures tend to spill over national borders into other countries.
24. There are certain functions that are absent or inadequate under the present circumstances and must be improved if EAS countries are to deepen integration. These functions may include facilitating the flow of information and enhancing mutual understanding; collecting and disseminating information about economic policies; enhancing mutual learning by exchanging views and analyses in relation to certain policies implemented by some countries; allowing more systematic evaluation of policy measures like benchmarking and peer reviewing; coordinating the policies of member countries; and enabling and facilitating collective decision-making.

25. To ensure that these functions are adequately performed in a systematic and regular manner, EAS countries need a standing mechanism that brings together member government officials to discuss measures and actions. EAS countries need to deal with an increasing number of issues pertinent for an official-level discussion, and the present top-down approach should be supplemented by a bottom-up one.
26. Working groups created on each of the priority areas will be the effective mechanism to drive integration of the sixteen countries even further. But these working groups will not be able to play the expected roles unless they are served by a group of competent staff. The ASEAN secretariat will continue to provide valuable support for the work of CEPEA. ERIA may be able to provide analytical and objective research that underpins meaningful policy discussions among policymakers. In the long run, the Study Group is of the view that in order to further deepen economic integration of the region it is necessary to establish a stable institutional foundation that combines research, consultation/coordination, and administrative functions. This will be achieved by expanding and strengthening the existing functions carried out by the above-mentioned existing institutions.
27. It should be noted that effective governance is important if this institutional development is to function properly under appropriate supervision of member governments. This supervision should cover key management matters that relate to the overall functions of the institution, such as the program of work, budgets, and appointment to senior positions. Ministers and senior government officials should be directly involved in exercising strong oversight on these activities of the institution.

7. Conclusion and Future Steps

28. The Track Two experts agreed that deepening economic integration and expanding intra-regional trade among the sixteen countries through economic cooperation, facilitation, and liberalization would generate very worthwhile benefits to the entire region, in terms of accelerating economic growth, narrowing development gaps, and achieving sustainable development. Especially, the experts shared the view that the current economic crisis has made realization of CEPEA as an established institution for economic cooperation more relevant. A number of specific areas have been identified where concrete actions are needed and where cooperative actions among the sixteen countries are particularly feasible. They also agreed that solid institutional arrangements should be in place, and laid out some ideas on how such arrangements might look. It is now the time for leaders and government officials to consider concrete steps to be taken in order to translate the ideas and suggestions contained in this report as well as in the Phase I report of June 2008.
29. The Track Two Study Group on CEPEA recommends to the Leaders of EAS through their economic ministers that:
 - (a) CEPEA's objectives and structure be reaffirmed at the Leaders' level so that a solid foundation for the development of CEPEA initiatives can be shared among member

countries.

- (b) Discussions be commenced immediately among the governments of the member countries on concrete steps to realize CEPEA, as a comprehensive framework which includes cooperation, facilitation, and liberalization. These steps should include an institutional development aspect, where inputs from the private sector and experts are weighed adequately.
- (c) The scope of the discussions should include stocktaking of cooperation measures and implementing status of existing ASEAN+1 FTA/EPAs, practical issues on trade such as streamlining of procedures and harmonization of ROOs, and a concrete timeframe for future governmental negotiation and implementation of cooperation, facilitation and liberalization measures.

Chapter 1 Introduction

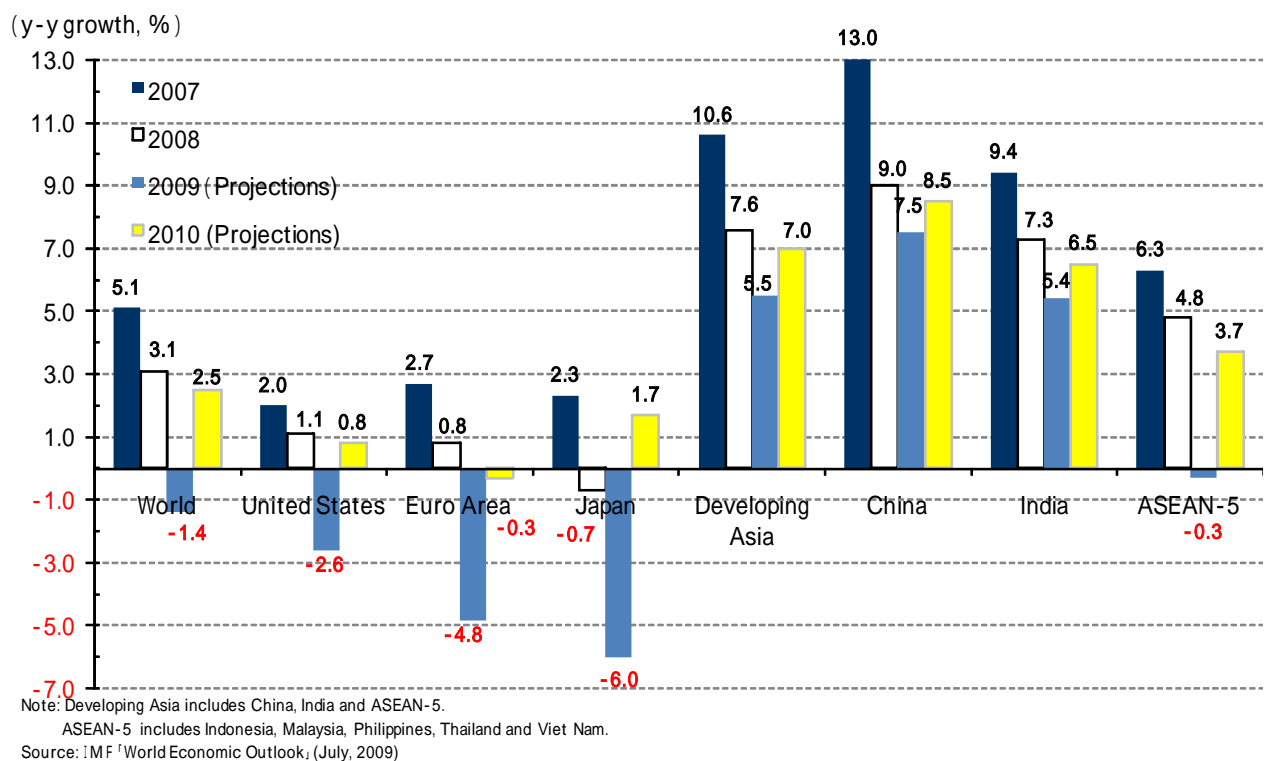
1. The Track Two Study Group on a Comprehensive Economic Partnership in East Asia (CEPEA) released its Phase I report in 2008 on the desirability of further regional integration among East Asia Summit (EAS) countries. The report set out CEPEA's objectives as deepening economic integration, narrowing development gaps, and achieving sustainable development. It was also affirmed that CEPEA would be composed of three pillars, namely economic cooperation, facilitation of trade and investment, and liberalization of trade and investment. The report was submitted to the Economic Ministers of EAS countries (AEM+6) in August 2008. At the meeting, Ministers noted the report and agreed to a Phase II Track Two Study on CEPEA detailing the pillars of economic cooperation, facilitation, liberalization as well as institutional developments.
2. Following the Minister's agreement, the study has been carried out with four meetings being held between November 2008 and July 2009. This report summarizes the discussions among the CEPEA experts and their written contributions.

Chapter 2 Development since the Last Report of June 2008

2.1 Global Financial Crisis and its Impact on EAS Countries

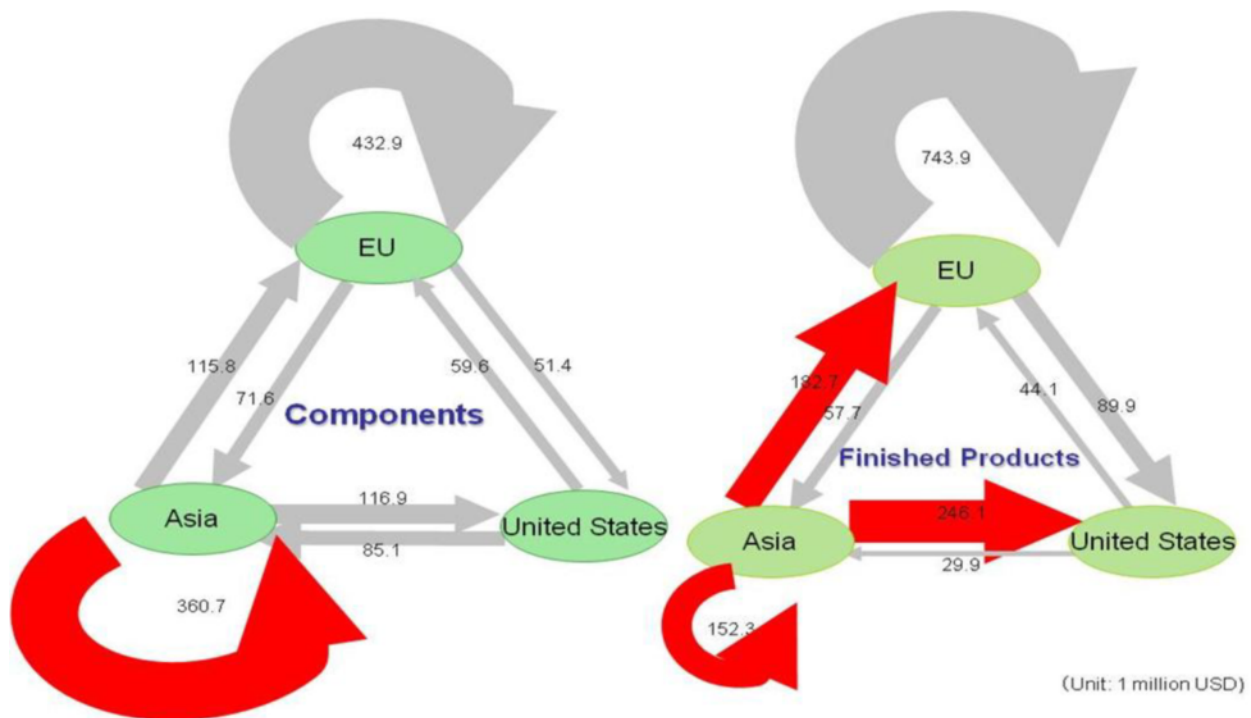
1. The worldwide financial and economic crises that originated in the US financial sector caused serious economic impact to the EAS countries with a magnitude far greater than the original expectations. Despite the fact that Asian economies were not as exposed to excessive leveraging or risky financial assets as the US or European countries, by the end of 2008 it had become overwhelmingly clear that Asian economies were being hit hard, particularly in the manufacturing sector. Asia's stock prices fell more sharply than those in advanced markets, and currencies tumbled. Foreign capital, which was an important part of the growth engine for many Asian countries, took flight swiftly, creating severe macroeconomic pressure in the region. The theory of decoupling Asian economies from the rest of the world has proven to be completely wrong (Figure 2.1.1).

(Figure 2.1.1) IMF Forecast of GDP Growth



2. These financial and economic crises and their severe impact on Asia have brought to light some risk factors associated with high dependence on external markets and concentration on a narrow range of industrial sectors. Although intra-regional trade in East Asia has developed, it has largely been the trade of intermediate goods with final products being shipped to other regions, especially the US and Europe (Figure 2.1.2). Even before this crisis, export dependency had risen to such an extent that lower consumption in non-Asian regions could easily result in sharp decreases in production, exports and economic activities.

(Figure 2.1.2) Trade of Components and Finished Products



(Source): RIETI-TID2007, Research Institute of Economy, Trade and Industry(RIETI)

3. Merchandise exports in East Asia declined from the second half of 2008 (Table 2.1.3), which ought to have adversely affected domestic production (Table 2.1.4) and overall economic activities. In light of the long-term prospect that the U.S. will have to reduce its external deficit, Asian countries must rectify this situation if they are to become more resilient in response to abrupt external shocks. Promoting demand within the region and establishing unfettered intra-regional trade to complement trade beyond the region should be one of the key strategies for achieving this goal.

Chapter 2 Developments since the Last Report of June 2008

(Table 2.1.3) Growth Rate of Merchandise Exports

	2006	2007	2008	2007			2008				2009	2008			2009				
				Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
	% change on yearly basis			% change from the same quarter in the preceding year								% change from the same month in the preceding year							
Brunei	16.6	-4.6		4.3	-0.3	30.1	-0.5												
Cambodia	26.9	10.7		-5.1	-0.1	4.1	25.3												
Indonesia	19.0	14.0	18.0	7.1	12.6	2.6	8.6	-2.4	14.7	-13.9	-32.5	4.7	-1.8	-18.7	-12.5	-12.9	-5.0	-5.1	
Lao PDR	59.5	4.6		31.6	-1.9	8.5	7.8	3.5	12.1	-36.3									
Malaysia	10.1	11.3	10.4	-3.9	9.4	8.6	-3.3	5.2	13.5	-15.6	-28.4	-2.6	-4.9	-14.9	-27.8	-16.0	-15.7	-26.3	-29.7
Myanmar	66.8	134.8	-14.5	-34.8	208.7	-80.3	115.1	-24.8	35.3	78.9		291.9	63.5	29.3	18.2	-49.6			
Philippines	15.6	6.4	-2.6	3.3	3.0	9.7	-9.2	2.3	2.5	-10.1	-37.1	-14.4	-11.4	-40.3	-37.1	-32.7	-35.2	-32.0	
Singapore	18.2	15.2	13.8	-3.0	8.2	4.3	3.9	-0.7	7.1	-13.4	-32.4	-4.3	-11.9	-20.4	-29.3	-10.2	-17.3	-13.9	-16.5
Thailand	18.7	3.1	27.6	0.5	9.6	22.5	-5.4	-8.2	31.3	-10.2	-30.3	2.4	-20.5	-11.5	-3.7	1.9	-11.7	-2.2	-6.7
Viet Nam	27.0	22.6	32.8	5.1	7.6	-1.2	18.8	2.2	22.5	-19.3	-26.3	20.1	-6.3	4.3	-1.1	67.6	39.8	8.3	12.8
Australia	16.7	14.0	33.3	0.9	-2.6	8.8	3.4	20.5	17.9	-6.7	-2.3	75.9	54.4	37.0	33.1	37.8	43.2	17.8	
China	28.0	33.3	26.6	12.5	10.6	0.0	1.8	8.3	15.1	-6.1	-29.5	19.1	-2.2	-2.8	4.4	-21.0	8.2	-5.7	-5.6
India	11.9	19.0	34.9	0.4	13.7	17.1	0.9	9.2	6.2	-24.9	-10.9	-12.2	-20.1	-5.3	4.7	13.2	-10.5	-1.9	
Japan	8.5	10.1	10.1	11.4	6.5	6.3	-14.6	7.5	10.7	-9.3	-49.7	-7.9	-26.8	-35.0	-41.5	-45.0	-44.3	-36.7	-38.8
Korea	14.8	14.2	14.4	6.6	0.9	14.0	-6.3	17.3	8.2	-9.4	-43.1	7.8	-19.5	-17.9	-24.8	-3.1	-7.7	1.5	-9.3
New Zealand	11.2	24.9	4.3	-17.4	7.1	25.5	-6.8	4.8	-11.7	21.0	5.8	13.6	9.3	4.3	27.7	20.9	22.6	15.2	

(Source) Compiled from data based on IMF, "International Financial Statistics", CEIC Database, Bloomberg, Department of Statistics Malaysia

(Table 2.1.4) Industrial Production Index in East Asia

(%)

	2006	2007	2008	2008				2009	2008			2009				
				Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
	% change on yearly basis			% change from the same quarter in the preceding year					% change from the same month in the preceding year							
Indonesia (2000=100)	-1.6	5.6	2.8	5.9	3.3	1.6	0.8	-	6.1	0.6	-3.9	-4.7	-2.4	-	-	-
Malaysia (2005=100)	4.8	2.3	0.5	7.2	3.1	1.4	-9.1	-14.4	-3.1	-7.9	-15.9	-17.9	-12.5	-12.7	-11.4	-
Philippines (1994=100)	1.6	-3.4	4.5	-0.3	7.7	10.4	0.3	-17.6	10.7	2.3	-9.6	-22.1	-18.8	-12.0	-	-
Singapore (2007=100)	11.9	5.9	-4.2	12.6	-5.7	-11.0	-10.7	-24.5	-12.2	-6.7	-13.4	-26.4	-12.5	-32.8	-0.5	-
Thailand (1995=100)	7.3	8.2	5.6	12.6	10.1	7.6	-8.0	-18.6	2.4	-7.7	-18.6	-21.2	-19.9	-14.9	-9.7	-
Australia (2001/02=100)	7.9	2.3	1.7	6.9	8.7	10.9	6.7	-1.0	-	-	-	-	-	-	-	-
China (2007=100)	16.6	18.5	12.9	16.4	16.3	15.2	12.9	5.1	8.2	5.4	5.7	-	11.0	8.3	7.3	8.9
India (1993-94=100)	11.6	8.1	-	7.0	5.3	4.7	0.8	-0.9	0.1	2.5	-0.2	0.4	-0.7	-2.3	-	-
Japan (2005=100)	4.5	2.8	-3.4	2.4	0.8	-1.4	-14.5	-	-6.6	-16.5	-20.7	-30.9	-38.5	-34.2	-	-
Korea (2005=100)	8.4	6.9	3.0	11.0	8.9	5.6	-11.3	-15.5	-1.9	-13.8	-18.7	-25.5	-10.0	-10.5	-8.2	-
New Zealand	-1.4	2.2	-0.9	2.1	2.6	-0.5	-7.1	-	-	-	-	-	-	-	-	-

(Note) Data not available for Brunei, Cambodia, Lao PDR, Myanmar, Viet Nam

Indonesia, Philippines, Singapore, Thailand = Manufacturing

Japan= Quarterly data follows Japanese FY (1Q= April-Jun, 2Q= Jul-Sep, 3Q= Oct-Dec, 4Q=Jan-Mar)

China=Quarterly data follows (1Q=Jan-Mar, 2Q=Jan-Jun, 3Q=Jan-Sep, 4Q=Jan-Dec)

(Source) Compiled from data based on respective governments' statistics

Chapter 2 Developments since the Last Report of June 2008

4. Furthermore, as the following table (Table 2.1.5) shows, the industry of each country is concentrated on a few specific sectors, such as in chemicals, electrical products, automobiles and their parts, iron and steel, textiles, etc. As a result, the regional economy as a whole could be easily affected by the decline of external demand.

(Table 2.1.5) Industry Structure in East Asia by Value-added Terms (Manufacturing) (by ISIC classification, Revision 3)

	1st	2nd	3rd
Cambodia (2000)	Wearing apparel, except fur apparel	Spinning, weaving and finishing of textiles	Processed meat, fish, fruit, vegetables, fats
	44.8%	34.2%	5.8%
Indonesia (2003)	Tobacco products	Food Products (incl. processed meat, fish, fruits, vegetables, grain mill products, Other food products, beverages)	Chemicals (incl. basic chemicals and other chemicals)
	12.0%	11.0%	10.2%
Lao PDR (1999)	Processed meat, fish, fruit, vegetables, fats	Wearing apparel, except fur apparel	Tobacco products
	33.7%	21.4%	12.0%
Malaysia (2004)	Electronic valves/TV, radio transmitters, receivers and associated goods	Chemicals (incl. basic chemicals and other chemicals)/Man-made fibres	Refined petroleum products
	18.7%	11.9%	11.7%
Myanmar ^{1), 2)} (2003)	Machinery (except electrical)	Transport equipment	Fabricated metal products
	35.8%	23.7%	12.5%
Philippines (2003)	Food Products (incl. processed meat, fish, fruits, vegetables, grain mill products, Other food products, beverages)	Coke oven products/refined petroleum products	Electronic valves/TV, radio transmitters, receivers and associated goods
	16.0%	14.8%	13.8%
Singapore (2004)	Basic Chemicals	Electronic valves/TV, radio transmitters, receivers and associated goods	Office, accounting and computing machinery
	28.9%	21.6%	9.7%
Thailand (2000)	Electronic valves/TV, radio transmitters, receivers and associated goods	Textiles (spinning, weaving and finishing, textile fibre preparation, etc)	Food Products (incl. processed meat, fish, fruits, vegetables, grain mill products, Other food products, beverages)
	9.6%	7.7%	6.9%
Viet Nam (2000)	Food Products (incl. processed meat, fish, fruits, vegetables, grain mill products, Other food products, beverages)	Non-metallic mineral products (incl. glass/glass products)	Apparel/dressing, dyeing of fur
	25.0%	10.6%	8.7%
Australia ¹⁾ (2001)	Food Products (incl. processed meat, fish, fruits, vegetables, grain mill products, Other food products, beverages)	Basic Iron and Steel	Motor vehicles/automobile bodies (incl. trailers & semi-trailers), part/accessories
	27.3%	18.1%	11.0%
China ²⁾ (2005)	Machinery electric	Industrial chemicals	Iron and steel
	16.2%	11.2%	10.1%
India (2004)	Basic Iron and Steel /Basic precious and non-ferrous metals, casting of metals	Chemicals (incl. basic chemicals and other chemicals)/Man-made fibres	Coke oven products/refined petroleum products
	19.0%	16.6%	11.4%
Japan (2004)	Motor vehicles/automobile bodies (incl. trailers & semi-trailers), part/accessories	Machinery (general, special)/domestic appliances	Chemicals (incl. basic chemicals and other chemicals)/Man-made fibres
	12.2%	11.5%	11.2%
Korea (2005)	Electronic valves/TV, radio transmitters, receivers and associated goods	Motor vehicles/automobile bodies (incl. trailers & semi-trailers), part/accessories	Machinery (general, special)/domestic appliances
	20.5%	10.2%	8.7%
New Zealand (2004)	Food Products (incl. processed meat, fish, fruits, vegetables, grain mill products, Other food products, beverages)	Structural metal products; tanks; steam generators	Publishing
	25.4%	8.7%	7.6%

(note 1) For Australia and Myanmar, "Share in Manufacturing Industry" is not available and is calculated manually.

No industrial statistics available for Brunei

(note 2) For China and Myanmar, the ISIC of economic activities are based on Revision 2.

(Source) Industrial Statistics, UNIDO INDSTAT2009 Database

5. Deteriorating employment is particularly worrisome. Unemployment has also risen to high levels. According to the International Labour Organization (ILO), the 2008 unemployment rate was 3.8% in East Asia¹, and 5.7% in Southeast Asia and the Pacific². However, in its worst scenario, these numbers are expected to rise to 5.5% and 6.4%, respectively. The ILO stated in its January 2009 report that “South-East Asia and the Pacific have profited through trade and other economic linkages from the economic boom in China and India, and the slowdown in these economies will have a negative impact in the region.”
6. In response to this sharply deteriorating world economy, the Leaders of G20 met in November 2008 and April 2009 and agreed to take united and concerted actions. The Leaders also voiced increased concern on protectionist moves and reaffirmed their commitment to resist such moves³. Six EAS countries - Australia, China, India, Indonesia, Japan and Korea - were represented at the meeting. Thailand, as Chair of ASEAN for the year 2009, also participated in the April meeting. This is a reflection of the growing importance of EAS countries in the global community.
7. In March 2009, the Leaders of ASEAN recognized the efforts to promote financial sector cooperation in various ASEAN-led fora including ASEAN+1, ASEAN+3 and EAS. The Leaders also underscored the importance and urgency of the strengthening of Chiang Mai Initiative (CMI), which is a framework of mutual assistance among ASEAN+3 countries. An important achievement was made at the ASEAN+3 Finance Ministers Meeting on May 3, 2009, where thirteen member countries reached agreement on all the main components of the CMI, including individual countries’ contributions, borrowing accessibility, and the surveillance mechanism. In addition, ASEAN+3 and EAS Leaders expressed their commitment to global and regional financial cooperation in June 2009.
8. Since April 2009, some signs of improvement are appearing in the market. It is still premature to conclude that the worst is over. In either case, Asia should not ignore the important messages that this economic crisis sent to EAS countries. Asian countries cannot go back to the old growth strategy that they followed until 2008. CEPEA provides the opportunity to transform the region’s economic structures. No single country can achieve this independently and without regard to other countries.

2.2 Time to Improve Economic Efficiency in East Asia

9. CEPEA provides a vehicle to transform the economic structures of member countries. This will be made possible if EAS countries can make improvements in the following three areas: first, to expand domestic demand within the region; second, to enhance overall economic efficiency through measures such as rational production specialization and strengthening production networks among the member countries; and third, development of infrastructure

¹ East Asia: China, Hong Kong China, Korea Democratic People’s Republic of, Korea Republic of, Macau, China, Mongolia, Taiwan, China.

² South-East Asia and the Pacific: ASEAN 10, East Timor, Pacific Islands (19)

³ In its report to the Trade Policy Review Body, the World Trade Organization noted that 75 trade-restricting measures were actually introduced from September 2008 to March 2009, of which 37 were the measures of CEPEA member countries.

that connects member countries. These developments will lead to the narrowing of development gaps in the region, as well as deepening integration. These three elements are directly related to the emerging consensus to rebalance economic growth in the region, which is considered to be the primary policy response to the 2008 economic crisis.

10. The first area is to expand domestic demand. The severity of the economic crisis is in large measures a result of over-dependency of manufacturing sectors on the markets of the United States and Europe. Looking to the future, there is no doubt that the US must reduce its current account deficit. Both the household and government sectors will have to cut down on their expenditure in the long run. This must be matched with increased demand within Asia, or Asian countries will suffer from a chronic over-supply situation. Within itself, East Asia has huge markets such as China and India, and these markets can make up for the contraction of the external market and become the new engine of regional growth. It is also noteworthy that while there are many EAS countries with a high dependence on exports, some countries, such as India, Australia and New Zealand, tend to run trade deficits. If these countries are united into one trade region, the overall trade for the entire EAS region will be much more balanced and resistant to external shocks.
11. The second area of improvement is enhancing overall economic efficiency through rational production specialization among the member countries. The concentration of industrial sectors shown in Table 2.1.5 does not necessarily indicate that efficient production specialization is achieved from a region-wide perspective. There would be duplication of concentrated sectors between countries. Eliminating such duplication and establishing a rational division of labor and efficient production networks would surely enhance the competitiveness of industry.
12. Developing physical infrastructure that connects member countries is the third area for improvement. A comprehensive approach such as the development of transportation coupled with improvement in customs procedures could reduce transport costs. As for domestic infrastructure such as water supply, sewage and housing, these are in short supply in many countries. Developments of these infrastructures enable efficient operation of offices and factories and consequently help narrow development gaps.
13. East Asia has developed a wide range of interdependent industries with tightly knit supply chains. But, continued development of a production network is necessary to raise the growth potential of industries to a higher level by achieving efficient resource allocation, which can be ensured through the free flow of goods, services, investments, capital, and people.
14. At the same time, an effective social safety net should be established so that people can feel more comfortable about spending for a high standard of living of their own. In spite of the fact that income is still limited, Asian people have high savings because they do not have sufficient social security systems such as pension schemes, medical insurance, and unemployment compensation. While building such social safety nets takes a long time, serious discussion must start without delay. Many Asian countries are witnessing sharp decline in birthrates. Such social infrastructures must be built before these countries move into full-fledged aging societies. EAS countries need to work together to ensure collective efforts and facilitate mutual learning through exchanges of information, peer reviews, and, wherever

feasible, policy coordination.

15. Investing in the struggle against environmental deterioration is an equally effective way to expand domestic demand. This investment will contribute to improving the quality of life without adding to already excessive production capacities. Environmental issues should not be considered as a problem only for industrialized countries. Countries at early stages of development are similarly impacted by both local and global degradation of the environment, and often their situations are worse as they are faced by severe resource constraints, both financial and technological. Again, EAS countries should develop a region-wide program for cooperation.

2.3 Further Progress towards a Region-wide FTA/EPA

16. In spite of the global economic crisis, the momentum in EAS countries toward FTA/EPAs has continued unabated. There have been important developments in the negotiation of FTA/EPAs. A number of FTA/EPAs have been successfully concluded and signed since the completion of the last report of the CEPEA Track Two Group. ASEAN-India FTA was concluded in August 2008. ASEAN-Australia-New Zealand FTA was signed in February 2009. The progress of these FTA/EPAs means that all “ASEAN+1” FTA/EPAs are now almost completed. In addition, bilateral FTA/EPAs in this region also moved forward. For example, China-Singapore FTA and Japan-Viet Nam EPA were signed in October and December 2008, respectively. Malaysia-New Zealand FTA was concluded in May 2009. The Republic of Korea (ROK) agreed to start new FTA negotiations with both Australia and New Zealand (Table 2.3.1).
17. Business sectors lost no time in taking benefits from these FTA/EPAs. These developments together with the agreements that are already in effect will help expand intra-regional trade and deepen economic integration. It should be noted, however, that several new challenges have emerged in the practical implementation of these agreements, such as customs procedure and the issuance of certificates of origin. This indicates that close monitoring of implementation is essential if these agreements are to produce the expected results.

(Table 2.3.1) Status of FTA/EPAs in the Region

Updates

- ASEAN and India concluded in August 2008
- Singapore and China signed FTA in October 2008.
- Viet Nam and Japan signed EPA in December 2008.
- Australia-New Zealand and ASEAN signed FTA in February 2009.
- Malaysia and New Zealand concluded in May 2009
- Launch of negotiations on South Korea-Australia and South Korea-NZ were announced in 2009

status as of June 25th, 2009

	Australia	China	India	Japan	New Zealand	South Korea	ASEAN	Brunei	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Singapore	Thailand	Viet Nam
Australia		□		□	⊙	□	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
China	□				⊙	□	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
India				□		□	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
Japan	□		□			□	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
New Zealand	⊙	⊙				□	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
South Korea	□		□	□	□		⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
ASEAN	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
Brunei	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
Cambodia	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙
Indonesia	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙	⊙	⊙	⊙
Lao PDR	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙	⊙	⊙
Malaysia	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙	⊙
Myanmar	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙	⊙
Philippines	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙	⊙
Singapore	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙	⊙
Thailand	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙		⊙
Viet Nam	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	⊙	

(1) symbols

⊙: FTA/EPA signed / concluded □: under negotiation

⊙: AFTA ⊙: ASEAN+1

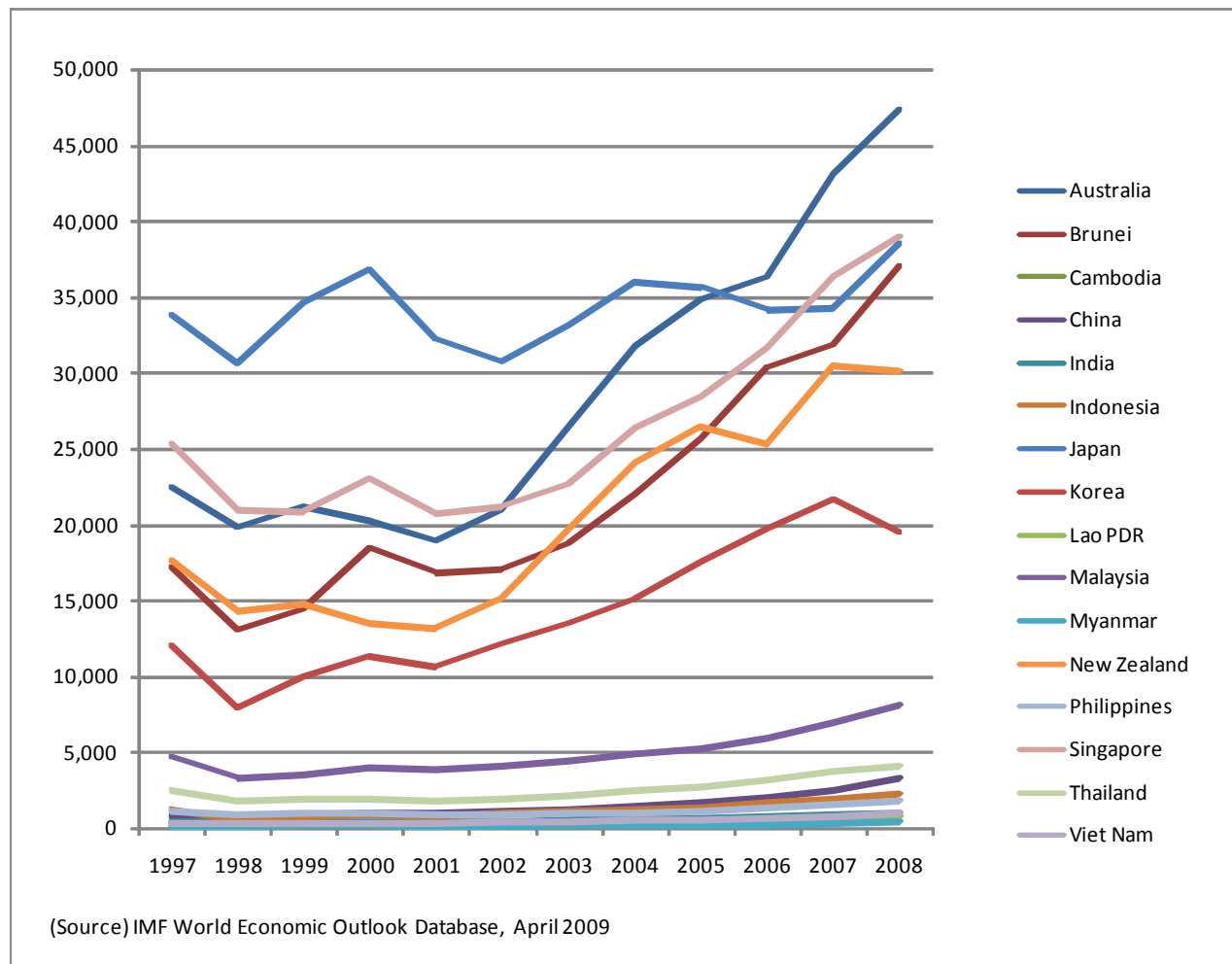
Chapter 3 Economic Cooperation

3.1 Introduction

1. One of the goals of CEPEA is to narrow the development gaps among the sixteen member countries. The region is faced with stark contrasts despite some signs of convergence and multiple initiatives designed to accelerate the speed of catching up. Development gaps are so wide that to establish and pursue common goals in this region is difficult. At present, per capita income ranges from US\$1,000 to US\$48,000 and this gap has been widening rather than narrowing in the last ten years. (Figure 3.1.1) There exist tremendous gaps not only in GDP but also in other selected basic indicators on human resources (Table 3.1.2). There is no doubt that if EAS countries are left to develop for themselves, this gap will not close. There is a need for rigorous efforts by the entire group to mobilize financial, technological and human resources to accelerate the economic growth of less developed countries.

3.2 Potential of CEPEA's Cooperation

2. The Track Two Study Group recommends cooperation projects that could start with capacity building in information gathering and research on development issues with a view to creating a level playing field for EAS countries. CEPEA consists of countries at different stages of development with different industrial structures. CEPEA members should ensure that resources for cooperation should be allocated according to the needs of people in member countries. Cooperation projects should be designed to maximize the opportunities for recipient countries to achieve faster growth and sustainable development. Prioritization and a focussed approach are even more important in light of the limited availability of cooperation resources. Members of the Study Group are of the view that cooperation through CEPEA should be built on existing cooperative efforts in the region, by coordinating them rather than duplicating them or competing with one another.
3. For CEPEA to implement effective cooperation, it could call for CEPEA-wide collective consultations and follow-ups. Through these consultations member countries can coordinate existing projects and identify the suitable cooperation areas for implementation. Additionally, they could take part in providing forum for some regional initiatives announced by the member countries.
4. Another potential of CEPEA's cooperation is to carry out region-wide cooperation projects. It should contribute to solving the issues of growing concern to the global community such as the environment and energy.

(Figure 3.1.1) GDP Per Capita from 1997-2008 (Current Account, USD)

(Table 3.1.2) Selected Basic Indicators on Human Resources for EAS Countries

	Population 2020 (Million)	Labor Force 2020 (Million)	GDP Per Capita PPP USD(2007)	HALE ¹⁾ at Birth	DALY ²⁾ per thousand population	Health Expenditure as % of GDP 2005 Total	Government Shares in Health Expenditure %	School Life Expectancy Primary to Tertiary
Australia	24	12.2	34923	73	110	8.8	67.0	20.5
Brunei	0.5	0.2	50199	65	130	2.0	79.6	14.0
Cambodia	18	10	1802	48	380	6.4	24.2	9.8
China	1431	834.3	5383	64	150	4.7	38.8	11.2
India	1362	589	2753	53	290	5.0	19.0	10.0
Indonesia	268	137.4	3712	58	210	2.1	46.6	11.6
Japan	122	60.1	33632	75	100	8.2	82.2	15.0
Korea	49	25.5	24801	68	-	5.9	53.0	16.6
Lao PDR	9	4	2165	47	400	3.6	20.6	9.2
Malaysia	31	15.2	13518	63	150	4.2	44.8	12.7
Myanmar	52	33.0	-	52	300	2.2	10.6	12.7
New Zealand	4.6	2.5	27336	71	120	8.9	77.4	19.5
Philippines	119	49.3	3406	59	190	3.2	36.6	11.8
Singapore	5	2.8	49704	70	110	3.5	31.9	-
Thailand	69	38.7	8135	60	210	3.5	63.9	13.5
Viet Nam	96	56	2600	61	170	6.0	25.7	-
EAS	3360	1870.2	-	-	-	-	-	-
World	7780	3681.3	9980	67	-	8.6	44.0	10.8

	Total Public Expenditure on Education as % of GDP 2005	Education Expenditure as % of GNI 2006	Adult Population with Tertiary Education as % of Total Adult Population (25-64 Years)	Annual Expenditure on Education Institutions per Student as % of Per Capita PPP GDP	Students Studying Abroad Latest	Teacher's Top Salary as % of GDP per Capita, Primary School Around 2004	Teaching Hours per Year at Primary School	Employers as % of Working Population
Australia	4.8	5	31.7	26	9833	144	888	3.1
Brunei	-	4	-	-	2468	-	-	-
Cambodia	1.6	2	-	-	2480	-	-	0.2
China	-	2 (?)	-	-	417351	-	-	-
India	3.2	3	4.9	22	-	615	1013	-
Indonesia	3.6	1 (?)	-	6	33904	104	1260	3.3
Japan	3.5	3	40.0	28	60225	211	578	2.6
Korea	4.4	4	13.5	29	101913	400	810	7.3
Lao PDR	3.0	1	-	-	2206	-	-	-
Malaysia	5.9	6	12.8	25	45195	183	792	3.4
Myanmar	-	1	-	-	2911	-	-	-
New Zealand	6.5	7	27.1	25	7355	149	985	6.5
Philippines	2.5	2	27.3	11	-	219	1182	4.5
Singapore	-	-	-	-	20322	-	-	4.9
Thailand	4.2	5	13.6	-	24082	-	1000	3.1
Viet Nam	-	3	-	-	23160	-	-	0.5
EAS	-	-	-	-	-	-	-	-
World	-	4	-	-	-	-	-	-

* Together with New Zealand

1) Health Adjusted Life Expectancy in Years

2) Disability-Adjusted Life Years or Loss of Life Years Due to Premature Death and Burden of Disease

3.3 Implementation of CEPEA's Economic Cooperation

5. Economic cooperation between ASEAN and its Dialogue Partners are covered under different enabling frameworks. The following are examples of frameworks and agreements that contain cross-sectoral cooperation.
 - Framework Agreements on Comprehensive Economic Cooperation between ASEAN and China (5 November, 2002)
 - Framework Agreements on Comprehensive Economic Cooperation between ASEAN and Korea (13 December, 2005)
 - Framework Agreements on Comprehensive Economic Cooperation between ASEAN and India (8 October, 2003)
 - Joint Statement on East Asian Cooperation (28 November, 1999)
 - Second Joint Statement on East Asian Cooperation (20 November, 2007)
 - Framework for Comprehensive Economic Partnership between ASEAN and Japan (8 October, 2003)
 - Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area (27 February, 2009)
 - Plans of Action to implement Joint Declarations on Strategic Partnerships – Australia (1 August, 2007)
 - Plans of Action to implement Joint Declarations on Strategic Partnerships – China (29 November, 2004),
 - Plans of Action to implement Joint Declarations on Strategic Partnerships – Japan (12 December, 2003)
 - Plans of Action to implement Joint Declarations on Comprehensive Cooperation – Korea (30 November, 2004)
 - Plans of Action to implement the ASEAN India Partnership for Peace Progress and Shared Prosperity – India (30 November, 2004)
6. Also, economic cooperation between ASEAN and a Dialogue Partner has resulted in a number of bilateral (i.e., between ASEAN and that Dialogue Partner) arrangements in specific areas. For example,
 - MOU (Memorandum of Understanding) on Strengthening SPS (Sanitary and Photo sanitary) Cooperation – ASEAN and China (20 November, 2007)
 - MOU on Agricultural Cooperation – ASEAN and China(14 January, 2007)
 - Plan of Action on ICT Cooperative Partnership for Common Development – ASEAN and China (14 January, 2007)
 - MOU on Transport Cooperation – ASEAN and China (27 November, 2004)
 - MOU on Standards and Conformance – ASEAN and CER (13 September, 1996)
7. Almost all of ASEAN's economic cooperation agreements with Dialogue Partners have a general provision to state that they support ASEAN economic integration, in particular the establishment of the ASEAN Economic Community, and that they contribute to the narrowing of development gaps within ASEAN as well as between ASEAN and the Dialogue Partner.
8. Economic cooperation between ASEAN and Dialogue Partners covers a lot of common areas. Aside from the Dialogue Partner support for ASEAN economic integration, cooperative activities are generally aimed at promoting and facilitating trade and investment. Accordingly,

activities are mostly in the areas of standards, technical regulations, conformities, assessment procedures (STRACAP), SPS, other non-tariff measures, simplification of customs procedures and the like. Also what are common to ASEAN's cooperation and collaboration with Dialogue Partners are activities in the areas of information and communications technology (ICT), human resource development (HRD), financial cooperation, tourism, transport and logistics, SME development, energy, and intellectual property rights (IPR). Electronic commerce, transfer of technology, competition policy, science and technology are other areas where ASEAN has, in one way or the other, economic cooperation activities with a number of Dialogue Partners (Table 3.3.2).

9. These programs have been undertaken and actually implemented mostly on ASEAN+1 bilateral basis. But under the present regime, it is far from clear to what extent they were coordinated with other projects and how they were followed up. Due to this bilateral nature and lack of information about individual cooperation projects, there is a real risk of spending the resources wastefully. Because there are many fragmented but overlapping projects, they may be prevented from achieving economies of scale and efficiency gains, particularly in certain network infrastructures, where interoperability and common standards are crucial.
10. Under the present circumstances, it may happen that certain countries or regions may attract unduly large amounts of resources, according to the donors' wish to strengthen ties with specific countries/regions with geopolitical importance. In fact, donor countries may not necessarily consider regional balance and thus their bilateral cooperation may not be able to narrow development gaps in the region. There is also a great risk of unbalanced distribution of resources over different fields. CEPEA could help improve this situation and raise the overall effectiveness of the cooperation programs, if a sufficient flow of information is assured among members and the necessary coordination and evaluation of projects are realized. This could also contribute to avoiding the risk of unbalanced distribution of such resources.
11. In addition, some of the initiatives taken by EAS countries call for CEPEA-wide collective consultations and follow-ups. Recent examples are the announcements of regional economic growth initiatives raised by several countries in the region. Japan's Prime Minister Aso made an announcement in his "Growth Initiative toward Doubling the Size of Asia's Economy" released on April 11, 2009. This initiative intends to mobilize US\$20 billion to support efforts in the areas of finance, the environment, human resource development, and infrastructure building. Another initiative was announced by China on April 20, 2009, an eight-point plan to enhance cooperation between ASEAN and China. The cooperation includes setting up a US\$10-billion China-ASEAN Fund on Investment Cooperation to speed up the construction of infrastructure networks between the two sides and improve their interconnectivity. China also provides US\$15 billion in credit for cooperation projects and an additional US\$5 million in the ASEAN-China Cooperation Fund. China supports ASEAN in various fields such as scholarships, food security, crime investigation, law enforcement and legal affairs in non-traditional security fields. Korean President Mr. Lee Myung-Bak also announced economic cooperation and cooperation on regional and global issues between Korea and ASEAN. The proposed areas of cooperation include transportation area such as logistics. Also, Korea reaffirmed its commitment to continue expanding Official Development Assistance (ODA), Human resource development (HRD) and capacity building, and announced its plan

to invite 7,000 trainees from ASEAN over next seven years. For global issues, Korea announced its “Low-Carbon Green Growth” initiative.

(Table 3.3.2) Major Cooperation Areas under ASEAN +1 FTA/EPAs and Other Regional Frameworks

		Customs	Trade & Investment	SMEs	Science and Technology	Human Resources	IPR	TBT/SPS	Movement of Natural Persons	Agriculture, Forestry and Fisheries	Tourism	Environment
ASEAN	ASEAN ¹	○	○	○	-	○	○	○	○	○	○	-
A+1	AUCEP ²	○	○	○	-	○	○	○	-	○	○	○
	ACFTA ³	○	○	○	-	○	○	○	-	○	○	○
	AKFTA ⁴	○	○	○	○	○	○	○	-	○	○	○
	AANZFTA ⁵	○	○	-	-	-	○	○	-	-	-	-
	AIFTA ⁶	○	○	○	○	○	○	○	-	○	-	-
A+3 ⁷		○	○	○	○	-	○	○	-	○	○	○
APEC			○	○	○	○	○	○	○	○	○	○

		Energy	Financial Sector	Competition	Government Procurement	Broadcasting	e-Commerce	ICT	Transport	Infra-structure	Business Environment Improvement
ASEAN	ASEAN ¹	○	-	○	-	-	○	○	○	○	-
A+1	AUCEP ²	○	-	○	-	-	-	○	○	-	○
	ACFTA ³	○	○	-	-	-	○	○	○	○	-
	AKFTA ⁴	○	○	-	-	○	-	○	○	○	-
	AANZFTA ⁵	-	-	○	-	-	○	○ ⁷	-	-	-
	AIFTA ⁶	○	-	○	○	○	○	○	○	○	○
A+3 ⁷		○	○	-	-	-	-	○	○	○	-
APEC		○	○	○	○	-	○	○	○	○	○

1 ASEAN cooperation under ASEAN Economic Community

2 Areas of cooperation refers to Agreement on Comprehensive Economic Partnership among ASEAN and Japan (AJCEP). Business improvement refers to specific article which has a business improvement committee.

3 Cooperation under ACFTA, in its framework agreement, states that “expand areas agreed by both parties and draw work plans. Also, Annex 4 of the framework agreement indicates an early harvest and areas to be expanded in the future (bio-technology, sub-regional development, mining, technology transfer)

4 Under the trade and investment area, a F/S for setting up the ASEAN Korea Center was conducted.

Areas of cooperation under AKFTA are areas stated under Chapter 3 of the framework agreement (○ on table above + mining, natural resources, shipbuilding, film)

5 Other cooperation projects under AANZFTA include RDO, Services, Sectoral Integration and Customs.

Cooperation here refers to the Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area.

6 Cooperation here refers to the Framework Agreement on Comprehensive Economic Cooperation between India and ASEAN. Broadcasting here refers to media and entertainment. Business Environment Improvement refers to business sector dialogues

7 Cooperation here refers to ASEAN Plus Three Cooperation Work Plan (2017-2019). Infrastructure is under development cooperation.

12. Although these initiatives will surely play a significant role in the development of the region, their impact would be greater if these initiatives were coordinated at the implementation stage to avoid wasteful duplication. These initiatives also deserve to be discussed extensively with other Asian countries. CEPEA can provide a forum for such multilateral discussions. In addition, the research capability of institutions such as ADB, ERIA and others can be utilized for objective evaluation of various initiatives.
13. When thinking of implementing the programs and initiatives as shown above, the idea of a structural fund which was suggested in the previous report by the Track Two Study Group of CEPEA might be worth referring to.

3.4 Possible Projects under CEPEA

14. CEPEA Track Two experts identified certain priority areas where region-wide cooperation will be particularly useful. The following are such fields that deserve serious consideration by EAS government officials.

3.4.1 Human Resource Development/Capacity Building

15. Human resources are the prerequisite for achieving further growth and narrowing development gaps effectively. Competent human resources can stimulate the free flow of goods, services, and the movement of natural persons as well as develop related infrastructures and so on. It is a very promising field for inter-governmental cooperation and has, in fact, occupied a very high rank in the priorities of development cooperation.
16. HRD or capacity building could be considered one of the most popular cooperation programs and thus various donors are conducting the programs according to their own know-how or skills. In this regard, CEPEA can contribute by streamlining the differences in the know-how/skills conveyed in these programs. HRD is crucial in improving the quality of public policies. Possible HRD cooperation by CEPEA may start with the training of government officials in relation to implementation, especially for areas such as administrative skills, energy and resource management. Discussions with officials from each country on certain fields could help develop the capacities of the participants through sharing information and experiences, especially for less developed countries to build a human resource base. In particular for less developed countries, special assistance is given to enhance administrative skills, the capacity to draft laws and regulations, an equitable and transparent tax collection system, and budget spending procedures, in addition to the regional cooperation programs mentioned above.

3.4.2 Improving Comparative Statistics/ information base on basic indicators

17. The Track Two Study Group revealed that considerable difficulties exist obtaining basic statistics and information that is necessary to identify problems and draw up plans to grapple with them. Table 3.1.2 shows some examples that indicate where such incompleteness, discontinuity of series and limited comparability exist. CEPEA's cooperation projects could start with basic cooperation such as collecting statistics.

3.4.3 Technology Transfer

18. CEPEA experts recognized that technology transfer to producers based in this region, especially in less developed countries, could enhance competitiveness. The experts rose that areas of transfer of technology could include manufacturing (especially for SMEs), agriculture, energy conservation, or environment. When combined, liberalization, facilitation and cooperation/assistance spur enhanced and more efficient regional production networks and encourage technology transfers that can deliver improved productivity growth rates.

3.4.4 Development of ICT Infrastructure

19. One area that has seen considerable cooperation in recent years is regional work on ICT questions, including e-commerce. The action plans within ASEAN and between some of its Dialogue Partners in the region could be the basis for some ICT cooperation programs and initiatives in CEPEA. Some of the regional works are outlined in the Annex.
20. ICT has enormous potential to enhance efficiency in reducing transaction costs, including the delivery of goods and services along with developing sufficient infrastructure. Establishing interoperability, the network effect, standards and regulations are some important areas for building consistency within the region. Also, security and data protection are possible fields of cooperation. For example, measures involving ASEAN include developing the legal infrastructure for e-commerce, facilitating the establishment of mutual recognition, conducting ICT training, etc.

Suggestions for CEPEA's cooperation include:

- Work towards common technical specifications and standards for ICT infrastructure to ensure interoperability;
- Work to ensure consistency among laws and policies relating to e-commerce, electronic data submissions, digital signatures, personal data protection and trade facilitation techniques;
- Collaboration and support in application of new technologies to support the development of e-logistics in the region; and,

- Capacity-building programs for personnel in less-developed economies and assistance to SMEs in the effective use of the latest technologies.

3.4.5 Improvement of Transport Infrastructure and Logistics

21. Transportation infrastructure is essential to industrialization and development. Cooperation in this area includes infrastructure development, such as roads, ports and airports, especially in the less developed regions. Coordination is necessary with the projects that are considered or already being conducted by other regional institutions such as the ADB (see below). The research capability of institutions such as ADBI, ERIA and others can be utilized in order to identify where CEPEA-wide projects would be the most useful. In addition, public transportation such as railways and subways can help improve traffic congestion and alleviate environmental concerns. In order to draw up such a plan for infrastructure development, countries first must have sufficient human capacity, which suggests that cooperation programs in this field must be mobilized quickly.

- Major Existing and Prospective Projects in the field of Trans-border Infrastructure Developments and in the Region
 - Greater Mekong Sub-region (in Transport Sector)
 - West-East Economic Corridors
 - North-South Economic Corridors
 - Kunming-Singapore Railway
 - Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA)
 - East Asia Industrial Corridors Project

3.4.6 Environment/Energy

22. CEPEA should make a coordinated response to global warming and other global environmental issues. These issues threaten not only the potential for economic growth, but also the achievement of sustainable development, especially in the developing economies. CEPEA includes two countries with large growth potential in energy consumption, China and India, as well as countries with the highest level of energy efficiency. This suggests that there is considerable potential for intra CEPEA cooperation on energy efficiency. Under CEPEA, possible cooperative actions include sharing information and past experiences of the developed countries, technology transfer, and setting regulations on issues such as mandatory recycling, minimum efficiency standards and labelling.

3.4.7 Rural Development

23. CEPEA experts recognized that some of EAS countries remain less-developed. Therefore, CEPEA should provide a vehicle or mechanism such as rural development cooperation to encourage these countries to better participate in regional arrangements. These measures such as infrastructure investments and vocational training are essential to bring a smooth transition

towards industrialization and integration in these countries. It is also essential to study such measures further in terms of social impacts and other possible outcomes to these countries such as environmental impacts and labour implications.

3.4.8 Building a Strong Basis for Small/Medium Enterprises (SMEs)

24. SMEs are an essential part of national economies. The dynamic growth of SMEs is necessary for building a strong industrial foundation. Across the world, SMEs suffer disadvantages in obtaining access to finance, technology, and markets and in securing skilled workers. But many EAS countries have highly developed programs to assist SMEs to overcome such disadvantages. However, in some other countries, there are many things that need to be done for these firms. Often they stand to benefit from the experiences of other countries. CEPEA's cooperation program may, for example, assist in building a financing scheme that best fits into the unique situations of individual countries as well as technology transfer, skills training, expanding market access and so on. One innovative scheme that was mentioned at the CEPEA Track Two meeting was micro-financing, which may be more widely utilized in the EAS countries.

Chapter 4 Facilitation

4.1 Introduction

1. International trade takes place under certain rules, standards and procedures that are set by national governments. In order to enhance the flow of goods, services, technology, knowledge and people among EAS countries, a stable business environment governed by transparent, predictable, streamlined and harmonized rules plays a very important role. As many FTA/EPAs have been concluded in East Asia, differences among these agreements have become increasingly cumbersome to business. For instance, a variety of different procedures and document requirements for the issuance of certificates of origin add to the cost of compliance for exporters. Sometimes detailed information on FTA/EPAs is not provided to traders and implementation or enforcement is not conducted in line with rules provided in the agreements. It is important to overcome these challenges and ensure the smooth implementation of existing FTA/EPAs.
2. In this regard, a vast number of facilitation initiatives have been undertaken in East Asia, and ASEAN has conducted many facilitation programs to settle the above issues. Also, the AEC Blueprint lists various facilitation measures as well. This chapter provides some arguments on these issues which have been identified as particularly important.

4.2 Rules of Origin

3. Rules of Origin (ROO) issues are widely recognized as critical elements in ensuring that the gains from economic integration are not undermined by complex rules. At present, each FTA/EPA in the EAS region has varying ROOs, which potentially leads to the 'spaghetti bowl' phenomenon. Table 4.2.1 shows that these differences exist not only in product-specific rules but also in the bodies that issue the certificates, the required information to be included in applications, and other related rules. The procedural aspects of these rules such as information requirements can be harmonized so that traders' costs will definitely be reduced. Though they may be technical not political in nature, such uniform requirements of documentation will surely reduce traders' costs. Since such procedural matters are handled by officers at customs clearance offices, the most practical approach is to call a meeting of such experts and business and instruct them to develop uniform documentation forms and procedures.

(Table 4.2.1) Procedure to Obtain AFTA COOs in Major ASEAN Countries

	Issuing Body	Issuing Place other than Issuing Body	Necessary documents for application of "Verification of Product Origin" (first step)		Days Required for acquiring "Verification of Product Origin"		Necessary documents for issuing Form D		Days Required for Issuing Form D	
			40% rule	CTC	40% rule	CTC	40% rule	CTC	40% rule	CTC
Thailand	Ministry of Commerce, Trade Preference Division, Department of Foreign Trade	Bangkok Port, Bangkok International Airport, Department of Trade Branch Offices (5 branch offices), Department of Commerce Offices (7 offices)	(Step 1) Exporter's Registration (Ministry of Commerce) (Step 2) Application for "Verification of Products Origin" 1) Request form for Verification of Product Origin 2) Certificate of Product Origin 3) Invoice and Customs documents for imported materials 4) Invoice for locally manufactured material purchased domestically 5) Production processing flowchart, Production cost, Product to be verified	Same as VA	3-5 days	Same as VA	1) Result of cost analysis 2) Application form for Form-D 3) Form-D (Details to be completed by the applicant) 4) Bill of Lading (B/L) or Airway Bill (AWB) 5) Invoice	Same as VA	0 ⁽¹⁾ /2 days	Same as VA
Malaysia	Ministry of International Trade and Industry (MITI)	MITI Branches (6) i) MITI Penang ii) MITI Perak iii) MITI Johor iv) MITI Kelantan v) MITI Sabah vi) MITI Sarawak	Manual application 1) Checklist 2) Application Letter 3) Application Forms 4) Company's registration Certificate or Business Registration Certificate 5) Invoices of raw materials used 6) Invoices from supplier to manufacturer (to be certified by manufacturer) 7) Certificate of Origin from supplier abroad (if raw materials from ASEAN, submission of Form D is required) 8) Product's processing flow chart 9) Product's samples photos/ catalogues Online application 1) Attach documents no. 4 until 7, submit online. 2) Application form 3) Cost analysis Registration form for online application 4) Checklist 5) Company's Registration 6) Invoice of raw materials (If the raw materials are imported from ASEAN, submission of Form D is required) 7) Production processing flow chart 8) Product samples photos/ catalogues	Same as VA (Even if the raw materials are imported from ASEAN, submission of Form D could be omitted) (Even if the raw materials are imported from ASEAN, submission of Form D could be omitted)	Manual application 7 working days Online application 5 working days	Same as VA	Manual application 1) MITI's approval letter 2) Invoices to customer and packing list 3) Bill of Lading 4) Custom's Declaration Form K2 Online application 1) Attach documents no. 2 until 4, submit online. 2) Customs declaration form (duplicate) 3) Invoice 4) Bill of Lading (B/L) * Use new Form D	Same as VA	Manual application 2 working days Online application 1 working day	Same as VA
Singapore	Singapore Customs	-	(Step 1) Factory Registration 1) Application for factory registration 2) Factory visit by Documentation Specialists Branch (DSB) → DSB will issue Registration Number, Approval Letter (Step 2) Application for manufacturing cost statement 1) Submit application (on company's letterhead according to the format prescribed by the Tariffs and Trade Services Branch) 2) Invoice (for every locally manufactured material). For ASEAN origin to qualify ASEAN cumulative content, submit Form D issued by the ASEAN country concerned.	same as VA (Step 2: Application Form) 1) Submit application (on company's letterhead according to the format prescribed by the Tariffs and Trade Services Branch)	(step 1) 1 week (step 2) 1-2 days (Cost Statement must reach Tariff and Trade Services Division Branch at least 7 days before export of goods)	Same as VA	Apply by EDI system, "Trade Net". Application letter of cost statement should also be submitted	Same as VA	2-3 working hours	Same as VA

	Issuing Body	Issuing Place other than Issuing Body	Necessary documents for application of "Verification of Product Origin" (first step)		Days Required for acuring "Verification of Product Origin"		Necessary documents for issuing Form D		Days Required for Issuing Form D	
			40% rule	CTC	40% rule	CTC	40% rule	CTC	40% rule	CTC
Indonesia	Foreign Trade Directorate, Ministry of Trade	Local Branches of Ministry of Trade	Cost analysis for the product	Submit cost analysis form with description of HS codes for both product and materials	0(1)-3 days	Same as VA	1) Export Application (P/E B) 2) Invoice 3) Bill of Lading (B/L) or Airway Bill (AWB) 4) Cost analysis	same as VA with HS codes	On the same day as application	8 working hours
Philippines	Bureau of Customs	Export Department of each ports	1. Full description of the product(s) intended for exportation 2. Final Country of destination of the product(s) 3. Complete list of materials, parts, components (both locally made and imported) used in the manufacture of the finished product(s), including their corresponding country of origin 4. Breakdown of the ex-factory cost, ex-factory price and FOB price of the finished product 5. Concise explanation of the processes to manufacture the finished product	same as VA	1 week	same as VA	1. Processed Export Declaration 2. Invoice 3. Bill of Lading	same as VA	On the same day as application	same as VA
Myanmar	Ministry of Industry No. 1 / Directorate of Trade and Department of Border Trade, Ministry of Commerce	Inspection Team (Cost Sheet Appraisal and Recommendation Group) of the Ministry of Industry No. 1 at Nay Pyi Taw & Yangon Directorate of Trade, Department of Border Trade (Yangon Branch Office) and some border trade posts	(Step 1) Application to Directorate of Trade, Ministry of Commerce to get recommendation letter (step 2) After getting recommendation letter from Ministry of Commerce, apply to Ministry of Industry No. 1. *Application with company letterhead. Attached documents are as follows: a) Declaration of Cost Statement of Product b) Recommendation letter from Directorate of Trade, Ministry of Commerce c) Import License for the raw material and accessories d) Invoice e) Import Declaration f) Packing List g) Certificate of Importer/Exporter Registration h) Certificate of Incorporation i) Certificate of Membership of UN/ECE j) Form XXIV (Company's BOD list) k) Sample (step 3) After getting recommendation from Ministry of Industry No. 1, again apply to Directorate of Trade to get the "Product Registration Card". **"Product Registration Card" including [step 1-3] should be renewed within 1 year.	Same as VA	About 4 days (for recommendation letter from Directorate of Trade) / About 15 days (Ministry of Industry No. 1)	Same as VA	Designated Application Form for FORM D to Ministry of Commerce Application with company letterhead to Ministry of Commerce signed by company's MD, GM, DIRECTOR level (All attachments shall be signed by company's responsible officials) Form D perfectly completed in English without correction 1) Product Registration Card (Need to submit the card's copy for following cases within 1 year after the first issuance) 2) Bill of Lading (Copy) 3) Invoice (Copy) 4) Export License (Copy) 5) Certificate of Exporter/Importer Registration (Copy) 6) Outlined Table of CEPT Application by Export License 7) Packing List 8) Export Business Registration (Copy) 9) Cost Sheet by Designated Form recommended by Ministry of Industry No. 1 (For necessary cases) [together with calculations by designated formula for Single Country Content and ASEAN Cumulative Content] 10) Commitment about 100% local raw material inclusion (for related cases)	Same as VA	2 days (For normal case, if you submit today and tomorrow FORM D will be issued)	Same as VA

(1) 0 means approval on the same day

(2) According to MITI, application procedure for Cost analysis can be submitted via online since January 2009. The required data may have changed as a result.

(Note) The translation is only indicative

(Source) Information obtained from interviews made by JETRO overseas offices.

4. The other issue on ROO has to do with cumulation rules. Depending on the way member countries use this rule, trade among EAS countries can be expanded. Cumulation rules allow products that have obtained originating status in one partner country to be further processed or added to products originating in another partner country, as if these have originated in the latter country. Under a region-wide FTA/EPA, this rule has an important function. It can influence both import and export prospects, that if they are too stringent, they may provide import protection but also scuttle export prospects and if they are too liberal, the converse may be true. Thus, a combination of different modalities can give the policy space to balance the objectives of export promotion and efficient imports actually originating from the partner countries. The scope of products which qualify under rules of origin can be widened under the cumulation rule. Depending on the way member countries use the cumulation rule, trade among EAS countries can be expanded. This effect can help facilitate production networks in the region.
5. While it was recognized that ROO could be used as a developmental tool, it was unanimously agreed that well-coordinated and streamlined ROO regimes would be in the interest of business enterprises in the EAS region, particularly for SMEs. 'Co-equal' ROO are gradually spreading in the region. A number of "ASEAN+1" FTAs utilizes an approach to rules of origin where the "change in tariff classification" (CTC) approach is considered co-equal to a regional value content (RVC) test. For most goods, this 'co-equal' rule is beneficial for exporters to have the choice of testing their products under a CTC-based rule or an equivalent RVC-based rule. Of course, rules applied under respective FTA/EPAs differ as ROOs are sometimes negotiated in a way linked with tariff negotiation. However, such user-friendly rules should be sought where possible. CEPEA could be the vehicle for pursuing harmonization and streamlining in the ROO regimes. As an initial step, work on ROO could focus on harmonization of procedures for the issuance of Certificates of Origin and for "self-certification", and enhancing cumulation rules for effective utilization of FTA/EPAs that can contribute to the expansion of intra-regional trade among the EAS countries. In this respect, complete harmonization/unification of ROO rules cannot be achieved easily without a strong political will.

4.3 Customs Procedures

6. Electronic Customs clearance is identified as an area of huge potential benefit. If the Customs of member countries are electronically linked and Customs information is shared, transaction costs can be dramatically reduced. ASEAN has an agreement to establish and implement the ASEAN Single Window (ASW), the ASW being defined as the "environment where National Single Windows of Member States operate and integrate." The National Single Window is basically a system in each member state which would allow the "single submission of data and information," synchronized processing of data and information, and single decision-making for customs release and clearance.
7. ASW might be a meaningful approach to expand this initiative and establish the East Asia Single Window. This approach can be conducted on a gradual basis. For example,

harmonization of application formats for customs procedures might be the possible first step for ensuring implementation of existing FTA/EPAs in the region.

8. Meanwhile, building on existing regional efforts in the area's economic cooperation and trade facilitation should also take into account the work being done in APEC, where 12 economies in the EAS process are members. On the Single Window, for example, APEC had the Single Window Strategic Plan adopted in APEC in 2007. The objective of this Strategic Plan is to provide a framework for the development of national Single Window systems to achieve "paperless trading targets and enable seamless data sharing."
9. The above approaches to establish "ASW" and "Single Window Strategic Plan" would be quite profitable for EAS countries to realize an unimpeded trade environment within this region. Both ROO and customs procedures are practical and technical issues and can be resolved through an official-level discussion. They should not call for difficult decisions by political leaders and yet they can serve enormously the goal of facilitation of trade in this region.

4.4 Standards and Conformity Assessment

10. Product standards and conformity assessment measures on a region-wide basis are worth considering. This is an area where efforts of ASEAN countries began fairly recently and where other members of the CEPEA might be able to assist ASEAN governments through sharing their experiences. This issue extends from industrial standards to professional qualifications. Standardization in manufacturing and quality managing processes can make these processes more efficient. Mutual recognition of professional qualifications will facilitate movement of natural persons.
11. Standards and the adoption by governments participating in regional arrangements of measures to avoid differing standards becoming barriers to trade are important regional integration issues that should not be ignored in the CEPEA context. The experience of the European Community is very instructive in respect of standards and it would be altogether natural for EAS countries to work to facilitate trade through a standards-related program.
12. Another important reason to consider CEPEA-wide activity on standards is that this seems to be an area where ASEAN countries' work is fairly new and where other members of the EAS region might be able to assist ASEAN governments through sharing their experiences related to standards questions in other agreements. Previous ASEAN instruments did not deal effectively with standards-related issues, but the new ASEAN Trade in Goods Agreement (ATIGA) does have important standards-related provisions.
13. In respect of product standards, it may be beneficial for CEPEA to build on the sectoral MRAs of the ASEAN Framework Agreement on MRAs and other MRAs that may be identified in ASEAN's work program. In this connection, a relevant cooperation area would be technical support and capacity building of the 'soft infrastructure' for conformity assessment and

compliance.

14. Standards, technical regulations and conformity assessment procedures are also the subject of future work at the regional level under the AANZFTA Economic Cooperation Work Program. Among the indicative activities that feature in the agreed work program is the establishment of a program of support designed to:
 - Enhance the transparent process of standards, technical regulations and conformity assessment procedures through information exchanges;
 - Facilitate cooperation between the Parties in the areas of standards, technical regulations and conformity assessment procedures; and,
 - Provide an analysis of the strengths and weaknesses of the regulatory and certification infrastructures of selected countries and identify areas for allocation of further resources.
15. Under the circumstances, and in the light of the imminent completion of the “ASEAN Plus One” process, Study Group members believe that there would be considerable scope for added value if CEPEA were used to build on existing efforts and launch a broader regional dialogue on standards and conformity assessment procedures.

4.5 Implementation of Facilitation Measures

16. As described above, there are a wide variety of measures for facilitation. In conducting such measures, facilitation measures under CEPEA should build on existing ASEAN initiatives. As ASEAN has played a key role as the driving force of economic integration in East Asia for years, it seems natural to utilize existing initiatives conducted by ASEAN. Accordingly, cooperation should start with reviewing and assessing ongoing ASEAN initiatives and discussing how they can be expanded to other EAS countries.
17. There should be no duplication with initiatives taken by other regional institutions such as ADB or APEC. If such initiatives are not sufficient, CEPEA should to improve on their approach, rather than doing the same things in a competing fashion. Finally, capacity building is important especially for less developed countries in the region when implementing facilitation measures.

4.6 Issues Relating to Domestic Regulations

18. CEPEA could foster increased regional cooperation and capacity building support to deal with issues relating to domestic regulations such as intellectual property rights, government procurement, investment protection, and competition policy. These issues are considered sensitive areas by some EAS countries. But the Study Group as a whole considers that these matters should remain open for discussion.

19. Issues such as intellectual property and competition policy cause certain nervousness among some EAS member countries. For example, competition policy is a complicated task and even developed countries with long experience of competition policy dispute its implementation. However, if EAS countries are to deepen economic integration with each other, a certain level of convergence on competition policy must be secured. For these issues, processes such as dialogue between national experts, information sharing and cooperation, at the very minimum, should be put in place under a CEPEA to work towards building understanding of members' policy settings and how they might impact upon other members. The AANZFTA contains a chapter on competition that covers the establishment of contact points, exchange of information and experience in the promotion and enforcement of competition law and policy, and exchanges of officials for training purposes. The crucial point is that it is important to seek to ensure that the benefits of trade liberalization in East Asia are not undermined by anti-competitive practices and reluctance to trade due to lack of protection for intellectual property.
20. The Study Group also recognizes the sensitivity of access conditions to government procurement markets for developing economies, but considers that this matter should remain open for discussion between CEPEA parties. Such discussion should enable EAS countries to examine the potential benefits that could accrue for international domestic suppliers and the potential domestic providers, particularly in the less developed countries. Policymakers should be reminded that beyond a certain point, political leaders must do their part if the EAS region is to make substantive progress toward a truly harmonized market, in the long run. Since some EAS countries have a very short history with these policies and their experience is limited, capacity building and human resource development for government officials should be given high priority.

Chapter 5 Liberalization

5.1 Introduction

1. Trade and investment liberalization is essential if further economic integration is to be achieved. Barriers to the free movement of goods and services, both tariff and non-tariff, must be eliminated rapidly. Over the past few years, EAS countries have made enormous progress in achieving bilateral or trilateral free trade agreements. The current economic crisis has reinforced the importance of expanding trade within the EAS region. Further liberalization is the essential step to achieve this objective, taking into account the special conditions prevailing in developing countries.
2. In the short-term, the EAS countries should oppose protectionism, and take collective steps toward further liberalization. In the long run, it is necessary to transform economic structures to make countries less susceptible to unexpected fluctuations in foreign demand, by encouraging domestic and intra-region consumption and investment. This chapter provides the latest analysis on what value liberalization under CEPEA can add and how liberalization under CEPEA can contribute to the economic integration.

5.2 Economic Effects of Integration under CEPEA

3. CGE analysis during the Phase I Study revealed CEPEA's benefit on the macro-economy of the region. The Phase II Study conducted another CGE analysis, based on the newest database, which shows the substantial impact of CEPEA-wide liberalization (Tables 5.2.1, 5.2.2, 5.2.3). According to this estimation, the impact on GDP of tariff elimination by the sixteen EAS countries could amount to more than one percent in four countries, while in some other countries it could be marginally negative. If the full effect of liberalization in combination with cooperation and facilitation is taken into account under the framework of CEPEA, however, the overall impact will be substantial, ranging from 0.9% for Japan to double-digit figures for Malaysia, Brunei, Viet Nam and Thailand. A comprehensive arrangement comprised of cooperation, facilitation and liberalization would produce considerable positive gains in terms of additional GDP for all EAS countries, particularly for developing countries. Effects on individual countries are larger in the case of EAS than ASEAN+3.
4. Now that numerous sub-regional FTA/EPAs including ASEAN+1 FTA/EPAs are completed or nearly completed, EAS countries have reached the stage where they should begin considering how they can integrate individual agreements into a coherent and seamless free trade regime. However, in order to make meaningful progress in this direction, countries that are not yet connected by bilateral FTA/EPAs should step up their discussion as to how they can positively participate in the negotiations to reach a CEPEA-wide FTA/EPA.
5. At the same time, the benefits of liberalization should not be lost to complexities of rules that might result from the existence of disparate FTA/EPAs – the so-called “spaghetti bowl” phenomenon. This makes the CEPEA-wide approach, which integrates five “ASEAN+1s”

into one, highly meaningful approach. Establishing a region-wide FTA/EPA, which covers all sixteen countries, will benefit the regional economy especially in terms of reduced transaction costs that would be brought about by harmonized rules, including ROO regimes.

6. While a region-wide FTA/EPA provides an ultimate solution, it cannot be achieved soon. In the meantime, it is also meaningful to address practical issues such as ROO and maximize the benefits of agreements so far concluded. This should be considered by government policy makers as early as is feasible. They can begin by learning the rules and procedures used in other agreements. This will be the first step towards harmonization and coordination of rules in a 'softer' way than making legally binding agreements. The example that AFTA changed its ROO so that its rules were the same as those of AKFTA and AJCEP demonstrates that such a 'flexible approach' often turns out to be effective.
7. At present, the rates of utilization of existing FTA/EPAs are low. For instance, the Asian Development Bank released a report on the utilization of existing FTA/EPAs based on surveys of 609 exporting firms in five East Asian countries in 2007–2008. The report revealed that the majority of the East Asian firms do not use FTA/EPAs. Only 29% of Japanese, 25% of Thai, 21% of Korean, 20% of Philippine, and 17% of Singaporean firms actually use FTA/EPAs (Table 5.2.4). The main reasons for not using them were "lack of information" and "slow procedures and administration costs" (Table 5.2.5). Resolving and ameliorating these technical and practical problems is urgently needed and therefore should be given high priority under CEPEA.

5.3 Analysis of Existing ASEAN+1 FTA/EPAs

8. Effects of existing four ASEAN+1 FTA/EPAs⁴ will be substantive, if they are put into practice as planned. A very high proportion of CEPEA-wide trade will be subject to tariffs of less than five percent by 2025 (Table 5.3.1, 5.3.2). It must be reminded, however that this analysis is constrained by inadequate data and information that are publicly available. Without high quality and sufficient quantity of information, meaningful tariff negotiation is impossible. There is a need for more reliable information about the tariff schemes of member countries. This is particularly true for the less developed countries. Improving these data sources should therefore be a priority area for future cooperation activities under CEPEA.

5.4 Impact on Production Networks as Seen in the Automotive Industry

9. Trade among the EAS countries is characterized by the deepening production network. One of the benefits generated by liberalization is the optimization of production and distribution systems on a region-wide scale. As different markets have become open to others as a result of FTAs, business strategies for production networks have changed. Concentration of production in one country has been replaced with more fragmented production that is spread across

⁴ ASEAN-India FTA is excluded because it has not been signed yet.

several different countries with more favorable conditions. The effect of such divisions of labor and horizontal production networks is clearly observed in the case of automobiles and auto parts.

10. The production blocks of the automotive sector have become increasingly fragmented throughout Southeast Asia. Automotive manufactures started their production networks in Southeast Asia with the introduction of the ASEAN programs such as the 1988 Brand-to-Brand Complementation (BBC) scheme and the 1996 ASEAN Industrial Cooperation (AICO) scheme, which reduced tariffs on some intra-regional and intra-industry trade. The automotive production blocks in Southeast Asia differ from country to country in terms of the intermediate products produced.
11. A recent Study by Poapongsakorn and Techakanont (P&T, 2007) on the Thai automotive industry provides interesting findings on the regional production network. The production and production capacity of automobiles in Thailand began rapidly in the late 1980s after the appreciation of the yen following from the Plaza Accord. It then accelerated in the early 1990s due to unprecedented economic boom and the government's liberalization policy. After the sharp decline during the 1997-98 Asian Financial Crisis, production jumped sharply and surpassed the 1996 peak in 2002. Several car makers have also expanded their production capacity as they had already made a strategic decision to use Thailand as their global production bases in the early 1990s. P&T emphatically argue that Thailand's ability to join the global production network can be attributed to
 - Thai government leadership in the establishment of the ASEAN Free Trade Area (AFTA) and ASEAN Industrial Cooperation (AICO)
 - The weak and fragmented sectoral economic policy formulation that has allowed the private sector to bargain with bureaucrats and with competing business groups
 - The adoption and adaptation of Japanese public-private cooperation by Thai policy makers during the period of the foreign debt crisis in the early 1980s.
 - the industrial decentralization policy in the late 1980s, which was in response to congestion problems in Bangkok, and the liberalization policy which took place in Thailand before other ASEAN economies began to follow suit

The following analysis of the auto parts and automobile industries in ASEAN shows beneficial production specialization through relocations and centralizations.

5.4.1 Analysis of Thailand-Australia FTA

12. Thailand-Australia FTA, which came into force in 2005, has affected the pattern of automobile imports by Australia. Table 5.4.1 shows that automobile imports of both family cars and business cars from Thailand have been increasing steadily, while those from Japan have decreased markedly. This implies that auto manufacturers in Japan moved their production sites to Thailand as they can enjoy preferable tariff treatment under Thailand-Australia FTA if they assemble their products in Thailand and export them to

Australia, rather than from Japan.

5.4.2 Analysis of the Auto Parts Industry

13. Analysis of car engine parts points to increasingly clear-cut trends towards relocation to and centralization in certain countries. Indonesia, Singapore and Thailand have picked up the lion's share of the production. By 2007, this industry had grown up to 38 times that of the 1990s in Thailand and 148 times in Indonesia. In contrast, Malaysia, which once occupied a relatively large share, has lost its position (Table 5.4.2). Other types of components makers, such as those producing steering wheels and gear boxes show different trends from the engine parts industry (Table 5.4.3 and 5.4.4). The steering wheel industry has become concentrated in Thailand and Malaysia and the gear box industry in Indonesia and the Philippines.

5.4.3 Analysis of the Automobile Assembly Industry

14. The automobile assembly industry presents the same trend as the car engine parts industry. The production of small cars (1,000-1,500cc) has been centralized in Thailand and Indonesia. Especially, it has grown by about 3,000 times or more since 2001, the low point in Indonesia. While it is still bigger than that of Indonesia, the production is declining in Thailand (Table 5.4.5 and 5.4.6). Meanwhile, production of medium-sized cars (1,500-3,000cc) has been centralized to Thailand; this industry's size is about 880 times its size in the 1990s.

5.5 Effects of Liberalization on FDI and Exports

15. These cases of auto parts and automobiles testify to the magnitude of the effects of the cumulation rule. Under a region-wide FTA/EPA, a change of tariff classification or added value which occurs in countries can be taken into account by the cumulation rule when determining the origin of goods, and thus the scope of goods which can enjoy preferential tariff treatment under an FTA/EPA expands. This rule permits manufacturers to choose the most efficient locations, regardless of tariffs, and to establish the most efficient production networks that expand across the entire region. As a result, liberalization of trade can accelerate the optimization of production networks on a wider scale and deepen value chains through consolidation of production sites.
16. The effects of FTA/EPAs on foreign direct investment (FDI) and exports are also significant. FDI into ASEAN10 has increased, and exceeded FDI into China in 2006 (Table 5.5.1). Such a sharp increase in inward FDI has helped expand production capacities in the recipient countries. In fact, ASEAN's exports show much higher growth than in Japan (Table 5.5.2). Generally speaking, the relationship between trade liberalization and the flow of FDI is not always clear-cut. However, from the analyses of the regional production network and value

-chain of automobile industry, the conclusion can be drawn that trade liberalization induces increase of FDI. Similar effect can be expected from CEPEA.

5.6 Potential Benefits of the Liberalization of Labor Movement

17. CEPEA Track Two experts also identified the need for further research of the potential benefits of cooperation in movement of natural persons within the region for both higher-skilled and lower-skilled workers in the region.
18. There is a growing consensus among economists that liberalizing the supply of services through the temporary movement of natural person could generate very large mutual gains to both developing and developed countries. It is estimated that an increase in developed countries' quotas on the inward movements of both skilled and unskilled temporary workers equivalent to 3% of their workforces would generate an estimated increase in global welfare of about US\$ 156 billion.
19. Despite the potentially huge gains from liberalizing Mode 4 and the commonality of interest between developing and developed countries little has so far been achieved within the framework of the GATS. There is however a significant opportunity in a region-wide CEPEA for the mutual benefits of increased temporary movement of labor to be realized. An increasing number of FTAs between countries in the region are recognizing this with gradual undertakings for increased labor market access for specific groups of professionals, businesspeople and tradesmen.
20. Perhaps a less known fact is that virtually all studies on the temporary movement of natural persons show that the greatest absolute and poverty-related gains for developing countries come from the liberalization of the low and unskilled⁵. Greater liberalization of Mode 4 would allow developing countries to exploit their relative abundance of low and unskilled labor and to better address development gaps within and between economies. Mode 4 service providers would benefit directly from higher real wages, some of which would flow back to the dispatching country in the form of remittances.
21. Nevertheless there is significant immigration, social and, for some, political challenges that need to be considered before a region-wide agreement might be tailored to best facilitate the mutually beneficial flow of higher and lower skilled persons. CEPEA could undertake modest steps in the consideration of such an agreement by initiating more detailed research on the potential benefits and challenges of the liberalization of movement of both higher and lower skilled workers in the EAS region.

⁵ See Winters (2002), Walmsley and Winters (2003) and Walmsley, Winters, Parsons and Ahmed (2005).

ANNEX

(Table 5.2.1) Trade-Weighted Tariff Rates for EAS+6 Countries

2003

	Japan	China	Korea	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	Cambodia	Myanmar	Lao PDR	Brunai	Australia	NZ	India
Agriculture and food	25.5	6.9	38.5	6.3	18.2	9.7	0.5	28.7	24.4	19.9	7.9	20.2	27.0	1.6	4.3	69.0
Fishing and Forestry	2.4	1.6	9.6	2.1	1.3	1.5	0.0	9.5	3.4	14.6	2.0	5.4	0.0	0.1	0.1	6.1
Mining and Extraction	0.0	0.3	3.9	0.2	1.4	3.1	0.0	0.2	2.6	1.0	2.1	1.2	0.0	0.0	0.0	11.7
Textiles, Clothing, Footwear	9.3	13.2	9.8	7.6	13.6	7.5	0.0	19.2	29.4	14.0	8.5	7.1	0.6	15.0	8.2	15.8
Wood & paper	1.0	4.2	3.2	3.4	6.6	5.6	0.0	16.3	11.6	9.9	3.5	10.3	1.1	3.2	1.5	13.2
Mineral products	1.2	9.4	6.3	3.6	5.1	4.2	0.0	11.1	8.8	11.8	2.1	7.3	1.1	2.6	1.9	13.9
Iron and steel	0.9	4.9	1.7	4.8	7.5	2.9	0.0	8.4	4.7	7.1	1.1	5.1	0.0	3.2	1.5	18.9
General machinery/metal products	0.5	5.4	4.5	5.7	5.8	4.6	0.0	8.0	4.4	10.3	2.9	5.6	0.0	3.1	2.1	14.9
Electronic Machinery	0.0	2.1	1.0	1.5	1.0	0.2	0.0	3.9	7.1	15.5	4.9	9.1	3.0	0.8	0.4	2.7
Transport equipment	0.1	8.6	6.0	5.6	12.0	4.6	0.0	11.9	11.9	21.6	2.7	13.6	26.9	4.8	4.2	14.3
Other manufacturing	1.2	15.0	9.0	8.4	6.8	7.4	0.0	6.9	23.0	20.4	8.9	8.3	4.1	2.9	7.9	14.8
Utilities and Construction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Retail and wholesale trade	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transport and Communication	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Authors' calculations based on GTAP7 database

(Table 5.2.2) Impact on GDP

% change in GDP quantity index

Region	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Japan	0.04	0.64	0.56	0.02	0.63
China	-0.03	4.65	4.64	-0.05	4.49
Korea	0.38	2.67	2.28	0.34	2.64
Indonesia	0.13	4.35	4.13	0.11	4.15
Malaysia	0.62	9.53	8.95	0.57	9.24
Philippines	0.12	5.95	5.51	0.11	5.77
Singapore	-0.02	3.83	3.65	-0.02	3.63
Thailand	0.59	7.46	7.17	0.56	7.21
Viet Nam	1.61	11.04	10.17	1.60	10.79
Cambodia	0.38	8.59	7.17	0.29	8.38
Myanmar	0.07	6.15	5.36	0.07	6.00
Lao PDR	0.40	5.99	4.69	0.40	5.94
Brunei and East Timor	1.86	6.98	6.14	1.86	6.92
Australia	0.11	1.27	1.20	-0.03	-0.03
New Zealand	0.08	1.94	1.77	-0.04	-0.02
India	0.45	3.40	2.70	-0.03	-0.07
Hong Kong	0.00	0.02	0.02	0.00	0.02
Taiwan	-0.10	-0.18	-0.15	-0.11	-0.17
NAFTA	0.00	-0.02	-0.02	0.00	-0.02
EU25	-0.03	-0.09	-0.09	-0.02	-0.08
Latin America	-0.02	-0.05	-0.05	-0.02	-0.04
Rest of World	-0.03	-0.08	-0.09	-0.03	-0.07

Source: Authors' calculations

Scenario 1	East Asia Summit: tariff elimination only
Scenario 2	East Asia Summit: tariff elimination plus trade facilitation plus cooperation
Scenario 3	East Asia Summit: tariff elimination plus trade facilitation plus cooperation; all agriculture and food products excluded
Scenario 4	ASEAN+3: tariff elimination only
Scenario 5	ASEAN+3: tariff elimination plus trade facilitation plus cooperation

(Table 5.2.3) Impact on WelfareEquivalent Variation⁶, % of GDP

Region	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Japan	0.18	0.92	0.92	0.17	0.92
China	-0.03	4.37	4.30	-0.05	4.22
Korea	0.68	3.27	3.02	0.64	3.23
Indonesia	0.68	5.13	4.57	0.17	4.51
Malaysia	2.08	13.23	12.45	1.51	12.35
Philippines	-0.06	6.18	5.80	0.01	6.08
Singapore	0.97	7.40	6.82	0.86	6.86
Thailand	2.35	10.01	9.08	2.43	9.84
Viet Nam	1.99	11.30	9.74	2.14	11.18
Cambodia	-0.06	7.08	6.02	-0.05	7.04
Myanmar	-0.47	6.01	5.48	-0.59	5.55
Lao PDR	-0.92	4.69	4.60	-0.84	4.72
Brunei and East Timor	5.74	13.35	12.68	5.55	12.84
Australia	0.84	2.49	1.87	-0.17	0.06
New Zealand	0.24	2.61	2.05	-0.21	-0.02
India	-0.19	2.77	2.44	-0.10	-0.09
Hong Kong	-0.48	-0.83	-0.76	-0.42	-0.72
Taiwan	-0.92	-2.52	-2.45	-0.85	-2.39
NAFTA	-0.05	-0.15	-0.13	-0.04	-0.12
EU25	-0.07	-0.18	-0.18	-0.06	-0.15
Latin America	-0.07	-0.19	-0.14	-0.05	-0.15
Rest of World	-0.10	-0.46	-0.47	-0.07	-0.36

Source: Authors' calculations

Scenario 1	East Asia Summit: tariff elimination only
Scenario 2	East Asia Summit: tariff elimination plus trade facilitation plus cooperation
Scenario 3	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation; all agriculture and food products excluded
Scenario 4	ASEAN+3: tariff elimination only
Scenario 5	ASEAN+3: tariff elimination plus trade facilitation plus cooperation

⁶ The equivalent variation is a measure of the amount of income that would have to be given or taken away from an economy before a change in policy in order to leave the economy as well off as it would be after the policy change has taken place. If the equivalent variation is positive, it is indicative of an improvement in economic welfare resulting from the policy change.

*(Table 5.2.4) Rates of Utilizing of Existing FTA/EPAs***Thailand (Exports)**

		2005	2006	2007	2008	2009(1Q)
Thailand	Australia	67.3%	62.6%	66.3%	61.9%	47.9%
Thailand	China	6.7%	12.3%	11.1%	10.4%	20.7%
Thailand	India (a)	17.6%	18.1%	14.0%	12.3%	8.7%
Thailand	Japan			b) 18.1%	22.4%	28.6%

Notes: a) "Early Harvest" provision for 87 items, b) 2007 Nov. - Dec.

Source: JETRO Business News 18/06/2009 and 09/03/2009

Malaysia

Ringgit million

FTA/EPA		Year	2007			2008		
			Total Trade	Utilize of FTA/EPA	Ratio	Total Trade	Utilize of FTA/EPA	Ratio
Malaysia-Japan EPA	Malaysia's imports from Japan		65,539	613 #	0.9% #	65,126	2,682	4.10%
	Malaysia's exports to Japan		55,241	6,745 #	12.2% #	71,800	8,360	11.60%
ASEAN-China FTA	Malaysia's imports from China		64,903	867	1.30%	66,882	1,601	2.40%
	Malaysia's exports to China		53,036	5,603	10.60%	63,210	6,333	10.00%
ASEAN-Korea FTA	Malaysia's imports from Korea		24,933	6 *	0.0% *	24,226	96	0.40%
	Malaysia's exports to Korea		23,033	1,365 *	5.9% *	25,888	14,315	55.30%

Source: Ministry of International Trade and Industry, Malaysia

Notes:

FTA figures for the period of July-December 2006 only since the FTA only came into effect in July 2006

* FTA figures for the period of June-December 2007 only since the FTA only came into effect in June 2007

Viet Nam

US\$ million

2007			Total Trade	Utilize of FTA/EPA	Ratio
ASEAN - China FTA	Viet Nam	China	3,360	288	8.6%

2007 Jun. - Dec.			Total Trade	Utilize of FTA/EPA	Ratio
ASEAN-Korea FTA	Viet Nam	Korea	762	346	45.4%

Source: JETRO Business News 26/12/2008

(Table 5.2.5) Impediments to Using FTAs (Number of Respondents)

Source: website of ADB

Reasons for Impediments	Japan	Singapore	Korea	Thailand	Philippines (a)
Lack of information	5 (33.3 %)	5 (25.0%)	41 (34.2%)	--	94 (70.1%)
Use of EPZ schemes /ITA	--	--	--	--	36 (26.9%)
Delays and administration cost (b)	8 (53.3%)	12 (60.0%)	13 (10.8%)	8 (22.2%)	41 (30.6%)
Small margin of preference	5 (33.3%)	12 (60.0%)	43 (35.8%)	6 (16.7%)	18 (13.4%)
Too many exclusions	--	--	--	9 (25.0%)	20 (14.9%)
Arbitrary classification of product origin (b)	--	--	--	--	31 (23.1%)
NTMs in FTA partners	--	--	5 (4.2%)	13 (36.1%)	12 (9.0%)
Confidentiality of information required (b)	4 (26.7%)	6 (30.0%)	--	--	17 (12.7%)
Number of Respondents (c)	15 (100.0%)	20 (100.0%)	120 (100%)	36 (100.0%)	134 (100.0%)

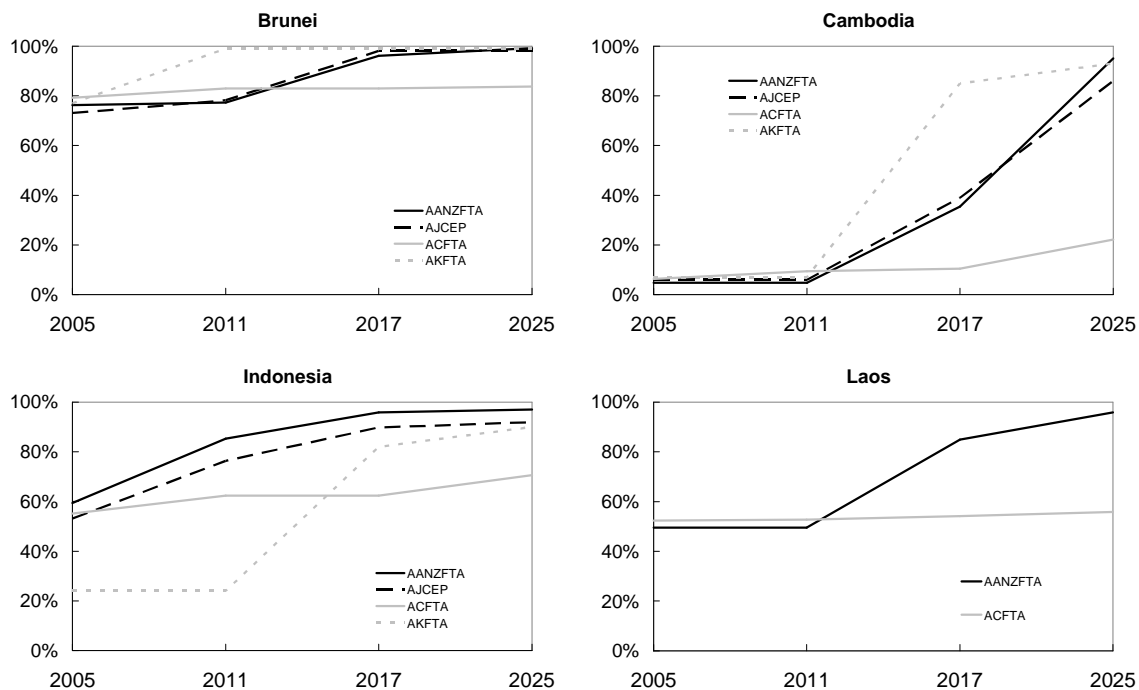
Notes: (a) AFTA only. (b) Rules of origin requirement. (c) Multiple responses were allowed.

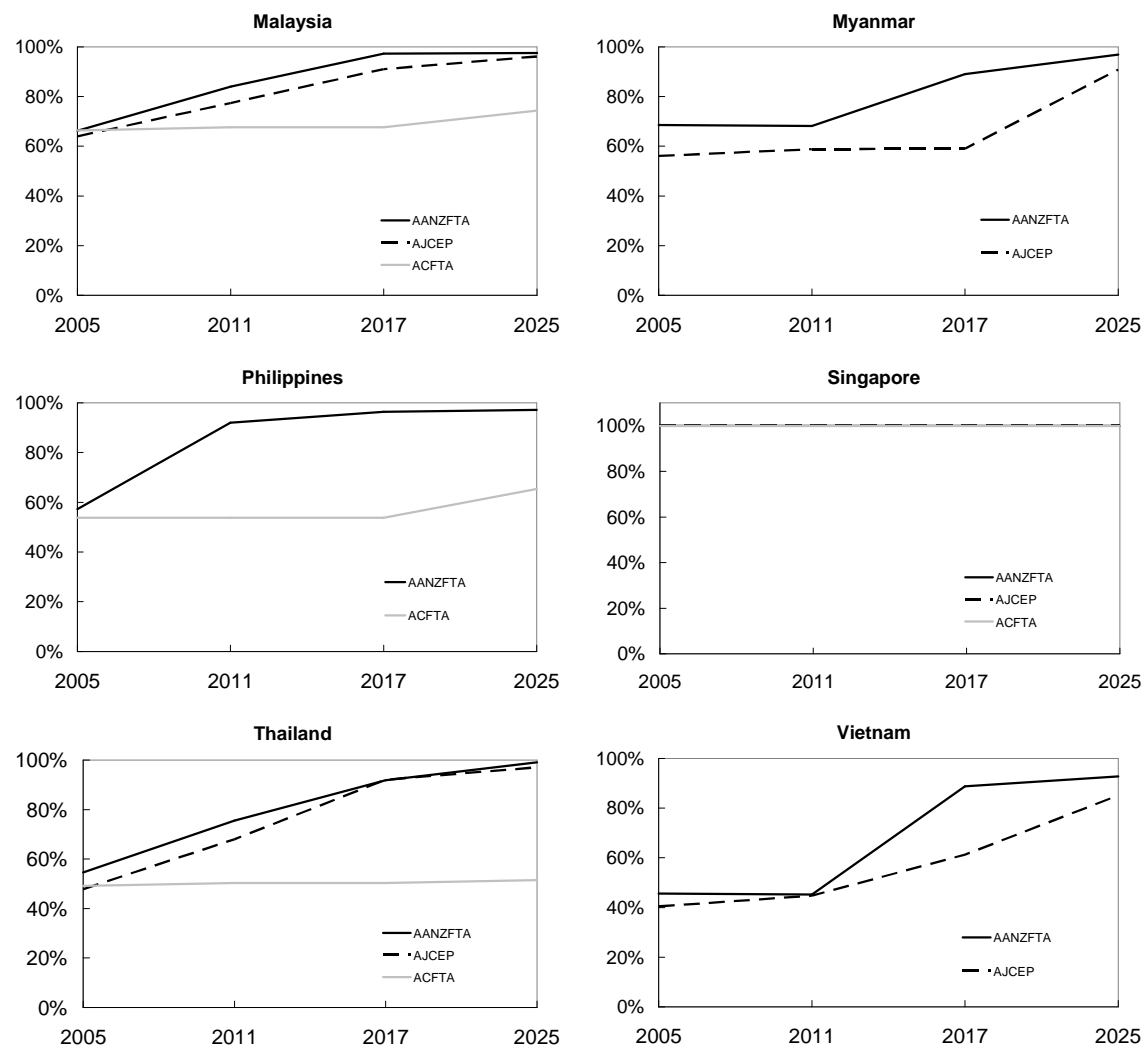
-- indicates option was not available in the survey for that country.

EPZ = export process zone; ITA = Information Technology Agreement; NTM = non-tariff measure.

(Table 5.3.1) 1 Percentage of Tariff Commitments in 0-5% Range – ASEAN nations

Percentage of total import tariff lines that will be reduced to the 0-5% range in each period

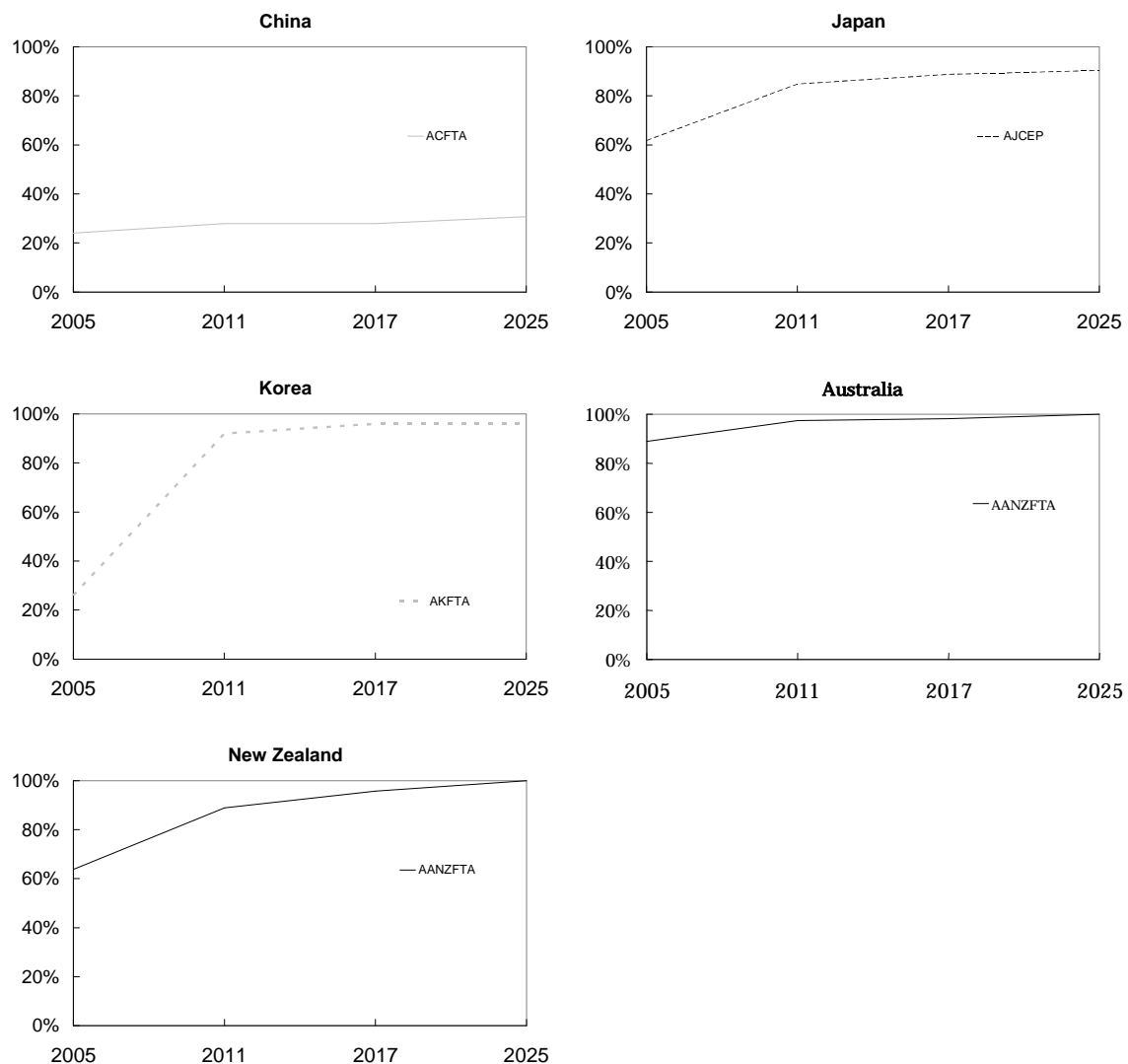




Source: NZIER

(Table 5.3.2) Percentage of Tariff Commitments in 0-5% Range – Partner Nations

Percentage of total import tariff lines that will be reduced to the 0-5% range in each period



Source: NZIER

(Table 5.4.1) Trends in Family Car/ Business Car Imports to Australia

			2004	2005	2006	2007	Compare 2007 to 2004
Family cars	Total amount of imports (US\$ million)		8,141	9,268	9,482	11,651	
	Share (%)	From Japan	58.9	55.1	49.6	45.3	-13.6
		From Thailand	1.1	2.2	4.8	8.5	+7.4
Business cars	Total amount of imports (US\$ million)		2,556	3,040	3,343	4,596	
	Share (%)	From Japan	43.8	29.9	28.3	27.6	-16.2
		From Thailand	25.3	38.1	32.0	36.3	+10.9

Source: Trade Statistics of Australia

*(Table 5.4.2) Process of Changing Export Value to ASEAN10 (US\$1000)***【Parts for Car Engines (840991)】**

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007
Indonesia	438	198	1,323	1,884	2,433	22,089	46,199	41,025	64,815
Malaysia	4,323	3,679	8,627	19,734	12,560	12,199	13,872	6,151	7,573
Philippines	7	0	13	5	47	68	768	33	8
Singapore	9,229	6,070	6,663	18,271	67,437	85,303	83,419	117,528	109,132
Thailand	6,145	16,341	26,263	47,130	62,868	105,576	138,267	165,438	235,583

Source: World Trade Atlas

*(Table 5.4.3) Process of Changing Export Value to ASEAN10 (US\$ 1000)***【Steering Wheels (870894)】**

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007
Indonesia	131	1,004	1,044	994	622	674	1,328	390	609
Malaysia	12,092	18,015	24,258	24,698	29,778	37,910	52,831	37,910	52,831
Philippines	0	12	20	53	34	23	231	70	37
Singapore	412	323	303	401	2,207	1,417	1,069	1,447	2,555
Thailand	3,238	7,353	7,009	7,556	9,666	18,348	28,850	26,066	59,606

Source: World Trade Atlas

*(Table 5.4.4) Process of Changing Export Value to ASEAN10 (US\$ 1000)***【Gear Boxes and Parts Thereof (870840)】**

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007
Indonesia	1	83	161	202	282	14,410	17,821	51,573	64,053
Malaysia	773	1,678	1,042	623	871	1,272	1,463	1,358	3,365
Philippines	73,491	106,568	85,037	107,727	117,136	147,836	174,911	95,339	121,266
Singapore	1,071	559	363	1,618	3,145	3,339	7,206	4,635	20,313
Thailand	13	73	51	31	16	29	121	133	1,708

Source: World Trade Atlas

*(Table 5.4.5) Process of Changing Export Value to ASEAN10 (US\$ 1000)***【Cars (1000cc ~ 1500cc (870322)】**

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007
Indonesia	3,467	1,609	48	409	446	55,445	24,569	100,909	158,962
Malaysia	5,044	5,879	3,382	3,761	2,127	3,863	13,296	5,554	17,542
Philippines	0	0	0	0	15,884	0	0	0	0
Singapore	1,473	1,762	2,484	1,608	9,574	5,330	1,364	619	366
Thailand	4,606	12,846	7,366	1,048	239,329	528,404	394,831	350,532	413,621

Source: World Trade Atlas

*(Table 5.4.6) Process of Changing Export Value to ASEAN10 (US\$1000)***【Cars (1500cc ~ 3000cc (870323)】**

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007
Indonesia	2,405	1,483	1,285	7,379	26,521	54,113	128,480	63,207	57,275
Malaysia	4,249	5,194	4,005	3,487	2,518	9,804	8,650	8,468	25,096
Philippines	11	464	74	23,903	137,927	152,158	168,009	86,124	57,931
Singapore	12,953	22,940	32,492	33,194	60,244	58,444	54,471	43,677	37,331
Thailand	692	12,023	17,806	22,213	121,551	233,187	460,870	504,745	610,102

Source: World Trade Atlas

(Table 5.5.1) The Amount of Direct Foreign Investment in ASEAN10 (US\$ million)

	2000	2006	rate of increase
Japan (reference)	8,323	-6,506	-
China (reference)	40,715	69,468	170.7%
ASEAN10	23,540	51,480	218.7%

Source: website of ASEAN-Japan Center

(Table 5.5.2) The Amount of Exports of ASEAN10 (US\$ million)

		2000	2007	rate of increase
Japan (reference)	export	478,179	714,254	149.4%
	import	379,530	621,870	163.9%
China (reference)	export	148,955	1,218,170	817.8%
	import	132,163	967,346	731.9%
ASEAN10	export	426,484	887,406	208.1%
	import	368,964	814,658	220.8%

Source: website of ASEAN-Japan Center

Chapter 6 Institutional Development

6.1 Rationale for Institutional Development

1. In the preceding chapters, a number of proposals were made to strengthen integration among EAS countries. But, in order to move from the stage of proposal to specific actions, concrete steps must be laid out and agreed upon among government officials who are responsible for the matters in question. This holds true for all proposals in the cooperation, facilitation and liberalization areas. Furthermore, there is a need for some mechanism for monitoring and following-up implementations by individual governments of those agreed actions. In many cases, government policies call for modifications and adjustments as situations evolve. These policy measures must be reviewed and evaluated periodically among the officials representing EAS countries, as the effects of these measures tend to spill over national borders into other countries.
2. Take the recent declaration of G20 to fight against protectionism as an example. In spite of the strong rhetoric, the fact is not exactly the same as what is implied by the statement. This shows that such an agreement often fails to produce the intended outcome, unless it is reviewed by an effective follow-up mechanism. As economic integration deepens, the impact of one policy measure taken by an EAS country has an increasing effect on other members. It would be even more undesirable if a policy is decided on without regard to others. There is a need for adequate exchange of information and consultation over the policies when they have cross-border implications.
3. In the cooperation chapter, several interesting ideas were suggested at the Track Two meetings, such as a cross-border transportation infrastructure and a structural fund. These ideas should be looked at more closely by experts in respect of their usefulness and feasibility. Concrete action plans must be worked out before they actually embark on such projects. In parallel, many cooperation projects are pursued bilaterally among EAS countries. While such bilateral cooperation is useful for narrowing the gaps, such an approach may run the risk of unbalanced developments, where certain countries receive generous aid while other needy countries get less. If CEPEA pursues balanced developments, systematic efforts are necessary to keep all these developmental projects within scope.
4. In the facilitation chapter, many technical and practical issues were identified, such as rules of origin, custom clearance procedures, safety standards, and so forth that should be examined by experts from EAS governments to sort out unnecessary differences and complications. A meeting should be called soon to address these issues.
5. When it comes to legally binding issues such as competition policy or intellectual property rights, there is a need for more learning by government officials as described in Chapter 4. For this purpose, some bilateral and plurilateral programs have been carried out among certain countries as part of their economic cooperation programs for capacity building. But it would be more cost effective if EAS countries conduct these programs collectively or coordinate them. Such common programs should be drawn up under the auspices of CEPEA. These initiatives will contribute to the harmonization of rules and standards in the long run.

6. Social security systems such as pension schemes, medical insurance, and unemployment insurance are inadequate or at incipient stages of development in many of the EAS countries. Across the world, there is no perfect model and each country must strive to establish a system that fits best into its particular situation and needs. Just imitating a system that works well in one country is not the right approach. But this does not mean that there is no scope for benefiting from the experience of other countries. Many of these problems are common among the EAS countries. Coping with aging population, for example, is one urgent issue that confronts most of the countries in this region. The advantage of collective learning would be great.

6.2 Necessary Functions for the Effective Implementation of Measures under CEPEA

7. These considerations point to one thing. There are certain functions that are absent or inadequate under the present circumstances and must be improved if EAS countries are to deepen integration.
 - The first function is facilitating the flow of information, both economic and social situations such as statistics, among the sixteen countries and enhancing mutual understanding. This information must be collected in an internationally comparable manner.
 - The second function is collecting and disseminating information about economic policies. There are instances when information is not made available as to how new policy measures are implemented, forcing individual countries and corporations to ask the government. It would be very beneficial if such information were made available through CEPEA.
 - The third function is enhancing mutual learning by exchanging views and analysis in relation to certain policies implemented by some countries. This includes discussion about the effect of one country's policy on other EAS countries.
 - The fourth function is allowing more systematic evaluation of policy measures like benchmarking and peer reviewing. Until now, these functions have been played rather on an ad hoc basis and in a limited way. But the effectiveness of such an exercise is far greater when they are carried out on a systematic and long-term basis.
 - The fifth function is coordinating policies of member countries when important gaps that may hamper the effectiveness of other countries' policies are found.
 - The sixth function is enabling and facilitating collective decision making at official levels. At present, only meetings of leaders and ministers are held regularly to discuss collective actions, but there are many technical and practical issues that can be better handled at official levels. If such policy coordination becomes possible, East Asian countries can

exert greater influence on global issues commensurate with their growing economic power. European nations are far ahead of Asia in this regard, but it is time for Asia to consider a similar collective approach.

6.3 Working Groups

8. In order to ensure that these functions are adequately performed in a systematic and regular manner, EAS countries need a standing mechanism that brings together member government officials to discuss measures and actions. Currently, EAS provides opportunities for regular meetings of key ministerial level representatives and allows officials to receive clear guidance from political leaders. However, EAS countries need to deal with an increasing number of issues pertinent for an official-level discussion and the present top-down approach should be supplemented by a bottom-up one.
9. This will result in working groups on each of these issues attended constantly by responsible government officials including senior level representatives. These groups can invite non-governmental experts and business leaders as necessary, but responsibility rests with national governments to make and deliver on commitments. Such working groups can serve all the purposes described above: facilitating the flow and sharing of information, exchanging ideas, mutual learning, and coordination of national policies.
10. In this region, there have been some existing frameworks such as ASEAN, ASEAN+1, and ASEAN+3. These frameworks have fulfilled some of the functions mentioned above in certain ways. Therefore, it would be most effective to build on these institutions rather than create entirely new ones. For example, one approach would be for existing working groups under ASEAN to invite concerned officials from +6 Dialogue Partners and discuss the issues related to the ASEAN+6 region. This suggests that ASEAN will continue to play a key role in bringing the 16 countries together and shaping the direction based on its pioneer experience in regional cooperation.
11. Working groups created on each of the policy areas will be the central mechanism to drive integration of the sixteen countries even further. But these working groups will not be able to play the expected roles unless they are served by a group of competent staff. They do the work of gathering information from member countries, putting together statistics and policy information, and identifying key trends and directions among member countries. They write research papers that highlight emerging policy issues and set agendas so that government officials can have meaningful policy discussions in a timely fashion. A coordinated multinational research body will be a useful source of such analytical research. High quality documents based on solid analysis and objective judgement are essential to fruitful discussion among member governments. It would be desirable that such a body play the role of an independent and neutral regional policy think tank.
12. The ASEAN secretariat will continue to provide valuable support for the work of CEPEA. In addition, though it was established just one year ago and still needs some organizational

development, ERIA may be able to provide analytical and objective research that underpins meaningful policy discussions among policymakers. In the long run, the Study Group is of the view that in order to further deepen economic integration of the region it is necessary to establish a stable institutional foundation that combines research, consultation/coordination, and administrative functions. This will be achieved by expanding and strengthening the existing functions carried out by the above-mentioned existing institutions.

13. It should be noted that effective governance is important if this institutional development is to function properly under appropriate supervision of member governments. This supervision should cover key management matters that relate to the overall functions of the institution, such as the program of work, budgets, and appointment to senior positions. Ministers and senior government officials should be directly involved in exercising strong oversight on these activities of the institution.

Chapter 7 Conclusion and Future Steps

1. The Track Two experts agreed that deepening economic integration and expanding intra-regional trade among the sixteen countries through economic cooperation, facilitation, and liberalization would generate very worthwhile benefits to the entire region, in terms of accelerating economic growth, narrowing development gaps, and achieving sustainable development. Especially, the experts shared the view that the current economic crisis has made realization of CEPEA as an established institution for economic cooperation more relevant. A number of specific areas have been identified where concrete actions are needed and where cooperative actions among the sixteen countries are particularly feasible. They also agreed that solid institutional arrangements should be in place, and laid out some ideas on how such arrangements might look. It is now the time for leaders and government officials to consider concrete steps to be taken in order to translate the ideas and suggestions contained in this report as well as in the Phase I report of June 2008.
2. The Track Two Study Group on CEPEA recommends to the Leaders of EAS through their economic ministers that:
 - (a) CEPEA's objectives and structure be reaffirmed at the Leaders' level so that a solid foundation for the development of CEPEA initiatives can be shared among member countries.
 - (b) Discussions be commenced immediately among the governments of the member countries on concrete steps to realize CEPEA, as a comprehensive framework which includes cooperation, facilitation, and liberalization. These steps should include an institutional development aspect, where inputs from the private sector and experts are weighed adequately.
 - (c) The scope of the discussions should include stocktaking of cooperation measures and implementing status of existing ASEAN+1 FTA/EPAs, practical issues on trade such as streamlining of procedures and harmonization of ROOs, and a concrete timeframe for future governmental negotiation and implementation of cooperation, facilitation and liberalization measures.

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Appendix. 2

Inputs from Experts

Australia

Brunei

Cambodia

China

India

Japan

Malaysia

Myanmar

New Zealand

Philippines

Singapore

Thailand

Viet Nam

Australia

Australia

Andrew Stoler

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1. Introduction

At their meeting in August 2008, EAS Ministers agreed to a Phase II Track II Study on CEPEA detailing the pillars of economic cooperation, facilitation and liberalisation, as well as institutional developments. In late November, Track II Study Group members agreed that each member should prepare a submission detailing their views on specific measures and initiatives that could be explored in greater detail through the Phase II work of the group. Study Group members were urged to focus on those areas with the greatest potential to deepen economic integration, narrow development gaps, and contribute to sustainable development. This submission provides an Australian perspective on these questions.

2. Economic Cooperation

In the course of its work to date, the Study Group has identified a number of areas where it believes that CEPEA could lead to enhanced forms of economic cooperation that could contribute to deepening economic integration, narrowing development gaps and achieving sustainable development. The CEPEA program of work should focus on those areas of cooperation where it is likely to have the greatest value added in building on ongoing regional efforts: coordination of a regional response to the global financial crisis and building the infrastructure for the region's future economic development through cooperation on information and communications technology policies.

2.1 Coordinated Response to Global Financial Crisis

A coordinated regional response to the global financial crisis is critical to ensuring that policy errors are avoided and that the economies of the CEPEA grouping maximize the leverage they can bring to the wider global effort aimed at restoring economic growth. An important part of what CEPEA can do is to enhance the role of systemically important emerging economies to ensure that these economies play their appropriate role in the G—20 process.

It now seems that the financial crisis is transforming to a broader crisis with economic and social implications. Governments are increasingly concerned over rising unemployment, and there is a

growing need to ensure that appropriate social safety networks and other policy settings are in place. Growing unemployment is likely to be a particular problem for many developing countries in our region and, in our study, we should reflect on how CEPEA might be used to establish a cooperative agenda on these issues.

One key form of cooperation should be the development and implementation of regional mechanisms that lead to improved sharing of information on actions taken to avoid deeper recession, including coordination on timing and objectives of stimulus packages. National treasuries need to be integrated into the regional process.

As another response to the financial crisis, CEPEA economies should give serious consideration to a region-wide “standstill” commitment to avoid raising protectionist barriers at this sensitive time. We cannot forget that the introduction of trade protectionist measures in the early 1930’s turned a financial crisis into a world-wide depression. Today, even without breaching their WTO commitments, governments in the CEPEA region have considerable room for unilateral protectionist actions that could undermine efforts to restore confidence. A CEPEA-wide standstill would eliminate the potential for back-sliding and send an important political message to the region and the world.

2.2. Information and Communications Technologies (ICT)

As noted earlier, CEPEA cooperation is likely to be most productive and of greatest value added when it can build on existing cooperative projects. An area that has seen considerable cooperation in recent years is regional work on ICT questions, including e-commerce. Through the ASEAN Australia Development Cooperation Program (AADCP), considerable work has been undertaken aimed at developing the legal infrastructure for e-commerce in ASEAN. The project, as originally conceived focussed on the core issue of legal recognition of e-commerce, but participants later enlarged the project to include a three-phase approach addressed to: harmonization of e-commerce legal infrastructure (2004-2005); online contract formation and online dispute resolution (2006); and mutual recognition of digital signatures (2007).

Following on the ongoing work being done under the auspices of AADCP, CEPEA could be used to deepen the cooperation in the region and also to extend it to economies not now collaborating on ICT work. Suggestions for work that could be backed by CEPEA include:

- Work towards common technical specifications and standards for ICT infrastructure to ensure interoperability;
- Work to ensure consistency among laws and policies relating to e-commerce, electronic data submissions, digital signatures, personal data protection and trade facilitation techniques; and,
- Collaboration and support in application of new technologies to support the development of e-logistics in the region.

3. Facilitation of Trade and Investment

Regional trade patterns, in particular, regional trade in electronic components and product “fragments”, demonstrate the integration of regional producers in global supply chains. Continued participation in these supply chains requires not only competitive manufacturing but also ongoing efforts at lowering transaction costs. Moving toward the adoption of best practice approaches to removal of unnecessary obstacles to trade should be an important shared objective of CEPEA economies. Among the areas where enhanced cooperation could contribute to trade facilitation are: rules of origin; improved customs procedures; technical barriers to trade and mutual recognition agreements in professional services.

3.1. Rules of Origin

Rules of Origin (ROO) issues are widely recognised as key elements in ensuring that trade agreements support regional trade integration. If ROO regimes are not well designed, then they can impair the ability of tariff liberalization to support regional integration and the development of supply chains. We can readily think of a number of ROO areas where CEPEA could make a contribution to the facilitation of trade.

With ASEAN + 1 agreements now finalised with all partners, work in the CEPEA context could focus on the identification of best practice approaches to the use of rules of origin in regional trade agreements.

Taking into account the importance of lowering transaction costs that negatively impact on CEPEA region producers’ participation in global supply chains, the Study Group could consider the potential for harmonizing ROO approaches for goods that are highly traded in the region.

In addition to the ROOs themselves, the CEPEA Study Group could examine the potential for making recommendations on a best practice approach to proving that goods meet origin requirements of trade agreements in the region.

3.2. Improvement of Customs Procedures

It is common for bilateral and regional trade agreements to incorporate chapters aimed at fostering greater dialogue between customs officials in the parties to the agreement. Although this might often seem like an opportunity for little more than information sharing, the exchanges – in particular on customs officers’ experience with new or different approaches to problem-solving –

could lead to simplified and streamlined border procedures. In addition, CEPEA-based enhanced customs dialogue should be seen as fitting well with the proposed cooperation on ICT questions. Through the CEPEA exercise we could examine possibilities for implementation of automated (ICT-based) customs procedures for all countries in the region, including for

- Single window operations;
- Risk assessment techniques; and,
- Acceptance of electronic documentation

3.3. Technical Barriers to Trade (Standards)

Product standards and the adoption by governments participating in regional arrangements of measures to avoid differing standards becoming barriers to trade are important regional integration issues that should not be ignored in the CEPEA context. The experience of the European Communities is very instructive in respect of TBT measures and it would be altogether natural for CEPEA countries to work to facilitate trade through a standards-related program.

Another important reason to consider CEPEA-wide activity on standards is that this seems to be an area where ASEAN countries' work is fairly new and where other members of the CEPEA region might be able to assist ASEAN governments through sharing their experiences with standards questions in other agreements. Existing ASEAN instruments do not appear to deal formally with standards-related issues, but evidently a new ASEAN Trade in Goods Agreement (ATIGA) that is expected to come into force soon does have TBT and SPS provisions. Under the circumstances, and in the light of the completion of the ASEAN + 1 process, it would be useful for CEPEA to launch a regional dialogue on standards and conformity assessment procedures.

3.4. Mutual Recognition Agreements in Professional Services

ASEAN countries are embarked on an ambitious program of developing ASEAN Mutual Recognition Agreements (MRAs) addressed to facilitating the movement and work internationally of professional services suppliers, including engineers, nurses and other professions. The Track II Study Group should examine the potential of CEPEA members to build on ASEAN work on development and adoption of mutual recognition agreements for professional services providers. Where non-Government bodies are responsible for accreditation and qualifications assessment, we could explore the possibility of CEPEA governments encouraging the development of MRAs by the private sector (there is some precedent for this in the North American Free Trade Agreement).

4. Liberalization of Trade and Investment

As was already noted in connection with our informal meeting in late November, the completion of the ASEAN +1 process has very important implications for the discussion in the CEPEA Study Group of initiatives aimed at region-wide liberalization of trade and investment. Quite likely, no two of the individual ASEAN +1 agreements are identical and their respective approaches to trade and investment liberalization probably diverge to an important degree. The Study Group needs to better understand the similarities and differences in the agreements in order to suggest the best building blocks for a CEPEA-wide arrangement.

4.1. Benchmarking Best Practice in Goods Trade Liberalization

As a first step, the Study Group should try to identify the degree to which CEPEA region governments have been able to liberalize completely in sectors or sub-sectors and under what conditions this complete liberalisation is to be realised (including timeframes). This should permit the group to develop a matrix of best practice in liberalisation against which less liberalizing agreements could be benchmarked.

As a second step, the Group could assess the possibilities for region-wide “zero-for-zero” tariff elimination initiatives that might be pursued on an accelerated basis.

It should be an objective of the Study Group to examine the extent to which existing agreements have been successful in liberalizing non-tariff measures not dealt with multilaterally. We should have a fix on whether the ASEAN +1 agreements have addressed questions like excise and sales taxes, individual product standards or regulatory requirements having an impact on trade.

4.2. Trade in Services

Two approaches to addressing trade in services in the CEPEA area could be explored by the Study Group. The first approach would be to first examine the extent to which it would be possible to pursue liberalization of so-called “embedded” services that are directly related to liberalization of trade in goods. Under such an approach, we would focus first on “enabling services” like financial services, telecommunications services, transport services and logistics services. Arguably, liberalizing these services would have the most significant overall impact because of their related impact on trade in goods.

A second approach could be to benchmark the most liberal standards in the region in terms of conditions applying to and length of stay provisions for “mode 4” temporary movement of

professional services providers (including provisions relating to the employment of family members).

4.3. Frameworks for Pre-Establishment Investment Liberalization

The Study Group should examine the possibilities for negotiating a common CEPEA-wide framework for the pre-establishment liberalization of foreign direct investment. A useful first step would be to benchmark the extent of actual investment liberalization in specific sectors (e.g. manufacturing, mining, agriculture) across CEPEA Parties. As part of this, the extent to which that liberalization has been bound or otherwise subject to commitments in trade agreements involving the CEPEA Party could also be examined.

5. Institutional Development

It is too early in the CEPEA process and too little is known about the actual and potential roles of existing institutions in the region to say already now that we need new institutions to support CEPEA. It is suggested that the Study Group should engage in a stock-take of existing institutions in the region as a first step to any study of whether new institutions might be required by CEPEA.

Brunei

Brunei Darussalam

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1. Introduction

The economic globalization as backdrop has accelerated the pace of regional grouping. The world now is divided in several regional blocks and zones. There are North America Free Trade Zone, and the Pan-American Free Trade Zone in America, the European Union in Europe and the African Union in Africa. Using the analogy of chopsticks ie. It's easier to break one pair of chopsticks than sixteen pairs of chopsticks bundle together.

Even superpower in the world feels the need to look for support in regional grouping. Thus, it is no coincidence that CEPEA reached a common understanding on an "expanded" concept of "ASEAN +6" Community. It is the need of the regional grouping development, the result of people's thinking and action pushed by regional grouping development and the inevitability of history such as the Asian financial crisis of 1997-1998. The financial crisis was a big jolt for Asian economy, it calls for greater unity and closer cooperation and it gives rise to the recognition that Asia needs to institutionalize its cooperation to solve similar issues and prevent new financial crises to set off within the region.

Although this multi-regional organization of East Asian, Indian Ocean and South East Asian countries does not necessarily share same geographical propinquity, culture and traditions, most of these countries experience same growth pattern. Many common challenges and matching resources call for mutual beneficial cooperation and exchange not only in economic sphere, but also in environment, social, cultural and educational realm.

2. Current Situation

ASEAN member countries, Japan, China and South Korea have been considering establishing an Asian regional FTA, consisting of these countries and others. As an institutional organization to cover each region, North America has the NAFTA and Europe has the EU. A possible Asian regional FTA is Asia's undertaking to catch up with the regional integrations in North America and Europe. The three proposals so far are as follows:

(1) East Asia Free Trade Area (EAFTA) consisting of ASEAN+3 (Japan, China and South Korea)

(2) Comprehensive Economic Partnership in East Asia (CEPEA) consisting of ASEAN+6 (Australia, India and New Zealand in addition to the three mentioned above)

(3) Free Trade Area of the Asia-Pacific (FTAAP) proposed by the United States

The FTAAP was formally proposed at the 14th APEC Economic Summit held in Hanoi in November 2006 where instructions were given to undertake studies on ways and means to promote regional economic integration, including an FTAAP as a long-term prospect, and report to the 2007 APEC economic summit in Sydney. It covers 21 APEC economies including United States, Canada and Taiwan which are not included in both CEPEA and EAFTA, however India is not included in FTAAP.

Of course, each of these three proposals has its distinct merits and demerits. A study on the EAFTA is most matured at this stage, having entered into a Phase II study. However, EAFTA does not include India, an emerging Asian economic giant. It also does not include Australia and New Zealand. On the other hand, the competitive advantage of CEPEA is that it includes these two important economies. Both CEPEA and EAFTA do not include the United States. This is understandable since United States is not located in Asia and it will be out of place to be a member of an Asian regional integration despite the fact that United States offers the biggest markets to many East Asian countries including Japan and China.

With these merits and demerits, there is question on which of these proposals should be implement first. There are three platforms for each of them to be discussed, namely the ASEAN+3 summit for the EAFTA, the East Asia Summit for CEPEA and the APEC economic summit for the FTAAP. In fact, it is incorrect of some to think of these three proposals to be mutually exclusive or they may be competing with each other on a first-come, first-served basis. Although the common goal eventually is FTA, these three proposals have different emphasis and competitive advantages that greater economic gains can be achieved if they complement instead of compete.

3. Suggestions

As we are all fully aware that the idea of CEPEA is rather different from the East Asian community ie. ASEAN +3. This new concept of including Australia and New Zealand and South Asian country of India is regarded as an “expanded” or wider concept of East Asian Community. It is virtually enclosing the whole Pacific-rim area.

ASEAN+6 is a multi-regional economic partnership currently house approximately 3 billion-population and US\$ 9 trillion economic capacity i.e. more than 20 percent of the world’ economic output. According to a report by the *Bermana*, Malaysian National News Agency (20 August 2006), “*CEPEA is an omnibus FTA for the entire region of some three billion consumers, of which more than 50 percent are youths. If it functions effectively, the market becomes wider and more attractive not only to the Oceanic countries but also to ASEAN members than ever before*”.

As discussed in the CEPEA Meeting held in Tokyo last November, the framework for CEPEA Phase II report does not have to start from scratch. It contains three key elements: Facilitation, Liberalization and Economic Cooperation. In addition, it also has a provision on the mechanism to facilitate/implement these three elements, and that is Institutional Development. In the context of facilitation, liberalization, economic cooperation and institutional development, the focus are on trade in goods, trade in services and investment; whilst at the same time provides flexibility to the newer ASEAN members as well as flexibility to address sensitive areas. Six suggestions merit attention for the CEPEA Phase II report (for brevity, will be referred to as Phase II report unless otherwise stated).

With respect to the key elements mentioned, the Phase II report should focus on important areas such as (1) Logistic Networks (2) Tourism, (3) Food Security, (4) Energy and (5) Environment. This is to facilitate the preparation of sectoral/area specific guidelines at the next stage.

At the same time, to give CEPEA a competitive edge, the Phase II report will be comprehensive and also deal with horizontal issues such as (a) ICT, (b) SMEs, (c) HRD, (d) Investment and (e) Competition Policy.

As mentioned previously, the EAFTA idea was also discussed at the ASEAN+3 summit held in Cebu, the Philippines, in January 2007. The EAFTA Phase II study, involving in-depth sector-by-sector discussions on details of the EAFTA, is thought to be mutually exclusive from CEPEA Phase II study. In fact, it is incorrect to think of them as mutually exclusive. For example, to effectively achieve the economic of scale benefits, CEPEA also needs to minimize business transaction costs by having similar rules and most important in this regard is the Rules of Origin (ROO), which constitutes one of the core features of a common framework. In essence, a common ROO can facilitate the spread of full cumulation and the development of regional networks. Thus, wherever appropriate, for complementarity purpose CEPEA Phase II can utilize the achievement of EAFTA Phase II study, including analysis in ROO.

There is no doubt that study on facilitation and liberalization should start with the stock-taking of existing FTA/EPAs in the region, and then consider how to develop the present network of FTA/EPAs into a region-wide FTA. Hence, the Phase II study should encompass a long term goal, taking into account the variety of differences in developmental stages and the varied interests of the countries in the region as well as to to examine value-added benefits that can be achieved from a region-wide FTA/EPA as well as the cost of FTA.

The achievement of CEPEA objectives depends very much on institutional framework. As APEC and ASEM show, if cooperation is to induce collective learning processes based on positive shared experience, then the crucial matter is how such cooperation is organized. The CEPEA Phase II study should focus on institutional development that underpins effective exchange of views and information, as well as discussion on the policies taken by member countries. Study on institutional development should highlight functions necessary to achieve CEPEA's short, medium and long term objectives.

Every region of the world has developed its own economic institution to promote economic development and integration. In Europe, the Organization for Economic Cooperation and Development (OECD) has helped European countries to consolidate their economies as well as tackle social, economic and governance issues. It is hopeful that in the future CEPEA will transform itself into the region's OECD.

To date, there is no agreeable approach to the forming of CEPEA FTA. One approach can be through [6 x (ASEAN+1)]. The second is to first develop an arrangement in Northeast Asia (China, Japan, Korea) and Asia Pacific (Australia, New Zealand, India), and subsequently link it to ASEAN. The third approach is an ASEAN+3+3 process. Although no efforts have been made to forge an agreement on which approach to take, in view of the multilateral relations in the Asian region, it appears that the [6 x (ASEAN+1)] may be the route taken. This suggests that ASEAN must act as a hub, which is in line with ASEAN's position as the driver in the ASEAN+3 process. It is essential that ASEAN should occupy the key position, and ASEAN at present and in future should lie in the geo-economic vital location. Thus, to make the position of ASEAN effective, capacity building programs should also be considered.

Cambodia

Cambodia

Prom Tevy¹
Royal Academy of Cambodia

1. Introduction

According the Track II Study Group in the phase I identified, the objectives of CEPEA are deepening economic cooperation, narrowing development gaps and achieving sustainable development. These can realize through the 3 important pillars: Economic Cooperation, Facilitation of Trade and Investment and Liberalization of Trade and Investment. At their meeting in August 2008, the Ministers of EAS countries agreed to the Phase II Track II Study on CEPEA detailing the pillars including institutional developments.

2. Economic Cooperation

The main objectives of economic cooperation are narrowing the development gap and regional sustainable development. From the point of view the situation in Cambodia following proposal can be made for consideration under CEPEA.

a) Agri-Business

At the time of financial crisis, which hits the recent emerging industries (Garment Industry, Construction and Tourism), economic cooperation under CEPEA in agri-business can less developed country, such as Cambodia, be integrated into more complex supply chain.

Land is the agricultural resource that is available in developing countries, used effectively and efficiently. The development of key infrastructure, such as irrigation system can be used such available resource better. The diversification of the agricultural product can use the huge un-skilled labor in the rural area. Agri-business can realize through capacity building skilled labor and management in combination with capacity on ICT. By creating an independent monitor of sanitary and phyto-sanitary and rural road can enable the speed of less developed countries into the regional integration.

¹ This report has been prepared with Ky Sereyvath, the International Institute of Cambodia.

b) SME

Agro-processing company in developing countries is not big or does not join association yet. Therefore, Small and Medium Enterprise play important role in regional integration instead of industrial sector.

For all sectors, the availability of quality and appropriate skills are problems. It is related to SME managers and ICT programmers with English and relevant computing skills. There is an abundance of low quality skill. This suggests that it is important to rationalize the processing sector in light of these needs and promote targeted course in coordination under CEPEA.

Technology and infrastructure are another fields which take its business in the SME improvement. Science and technology are key constraint in improving productivity. Technology is used in all sectors in Cambodia is old or underdeveloped, and there is hardly any incentive to upgrade technology. Telecommunication companies could also encourage to invest in infrastructures sharing and to share current existing infrastructure, in order to increase economies of scale and reduce cost.

CEPEA can support the creation of adequate non-farm livelihood and employment opportunities in rural areas through the creation and growth of micro and small and medium enterprise and coordination to extend social infrastructure, such as rural education and vocational training, in terms of quality as well as quantity

The last but not least, rules, regulations and institutions are still important. The enforcement of the regulatory framework is often weak and not transparent, and this has effected to agri-business, SME, and Infrastructure development.

c) Human Resource Development

Currently Cambodia is facing lack of human resource as many countries does. In the last a few decade of HRD of the country after civil war, Cambodia can use those qualified people mostly for the education sector, due to high population growth and build fundamental of the society. Only a few people can use their knowledge to work for the industries. According to WEF Competitiveness report 2008-2009 Cambodia scores lowest among ASEAN countries on health and primary education and especially weak at higher education and technological readiness, business sophistication and innovation. Now FTA is coming into the region, we need qualified people whether as skilled labor or manager for doing business equally with other member of EAS countries.

Qualified people can diversify agricultural product, instead traditional one, manage agro-processing SME and do the agri-business. Human resource with specific skill is also needed for FTA/EPA negotiation as well as the development of rule and regulation for doing business in the region.

3. Facilitation of Trade and Investment

The development of hard and soft infrastructure play a vital role in facilitating trade and investment, lowering transactions costs and expanding linkages to the regional supply chain and production networks.

In Cambodia, quality and quantity of road infrastructure is much weaker than the ASEAN countries. The cost of electricity, ICT is very high.

In term of rules and regulations is often very weak and lead to cause some problems for trade and investment. There is no competition law as well as regulation in the ICT.

To facilitate trade and investment, the condition need to be improved, in order to reduce obstacle in doing business and reduce the cost. Under coordinating of CEPEA, the following point should be paid attention to:

- Port and related logistics infrastructure improvement
- Review all existing rules and regulation in CEPEA member countries and make it into one, a single window for East Asia.
- Capacity building for custom officers

4. Liberalization of Trade and Investment

In general mechanism, Liberalization is so important for regional integration in order to fight into the regional market without barriers. Although, it is important, the countries face some struggles, especially, developing countries. To ensure the equality of doing trade, developing countries have to enhance and standardize the production sector, services and labor force, unless, those of them become the market place for developed countries to flow their products, service and culture also. In our view, Liberalization of trade and investment under CEPEA can realize step by step, because developing countries or new members of ASEAN are not ready to participate.

Topics should be considered under CEPEA are:

- Review first the real impact of FTA (ASEAN+1 and ASEAN+3) especially for the new member of ASEAN.
- Ensure benefit of SME, business association and
- Ensure national development goal.

5. Institutional Development

The roles and functions of existing institution in the region, such as EAS, Ministerial Meetings, ASEAN Secretariat, ADB, and World Bank are important in economic cooperation, trade facilitation, and liberalization.

For a new FTA in East Asia, a kind of coordinating office will be needed. We propose:

- An office for coordinate cooperation measure, monitor under ASEAN secretariat, because ASEAN as driving force of the new regional FTA OR
- An establishment of a CEPEA secretariat recognize by EAS.

China

China

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Roadmap of East Asia Economic Integrations

1. CEPEA is initiated as a institutional building process under East Asia Summit (EAS). It's main objectives are considered as deepening economic integration, narrowing development gaps and achieving sustainable development. To achieve these objectives, its scope should consist of three pillars - cooperation, facilitation and liberalization. It can also be an appropriate framework to resolve regional issues such as energy, environmental protection and sustainable development in general under these three pillars. It is considered that CEPEA should be three key features: ASEAN as the driving force, economic integration for the economic and social benefit of all the people and taking into account 'open regionalism.
2. Economic integration in East Asia has been driven by capital flow from more developed economies to less developed economies, which have facilitated the capital and technology transfer and developed a vertical economic growth chain in East Asia and by trade and FDI friendly policy and open market strategy, i.e. liberalization of the markets, adopted by East Asian economies that have reduced the transaction cost significantly and made the market based economic integration easily. Economic integration has created more and more shared interests, which has helped to develop a regional spirit and conscious. East Asian cooperation institutions have been nurtured under an "ASEAN +" framework since the Asian financial crisis happened in 1997. The major frameworks are "ASEAN", "ASEAN+1s", "ASEAN + 3", as well as "East Asian Summit". Those serve as the regional platforms for all members to engage and cooperate through dialogue and joint activities. FTA/EPA is the major part of the regional effort in deepening the economic integration. East Asia has been characterized by multi-layered FTAs that seem counter productive to the existing production network which is essential to the dynamics of the regional economies. Thus, it is essential for the region to promote the process toward a regional integrated FTA/EPA.
3. The current East Asian integration and cooperation has shown its new characteristic feature that is more economic-centered, equally participated and consensus built. The regional cooperation is more characterized by a kind of "functional approach. ASEAN, based on its pioneer experience for regional cooperation, plays a key role in bringing East Asia as a region together and shaping the direction. ASEAN under its new Charter has determined to establish ASEAN Community (with three Communities in nature) by 2015. The other East Asia members should fully support ASEAN's effort since this is crucial

for it to continue to play a leading role in East Asia integration and cooperation. The current East Asia cooperation frameworks should help ASEAN to keep its economic dynamics and at the same time to reduce intra-ASEAN development gaps.

4. As economic development in East Asia has been led by the progress of production network, further economic growth can be pursued through deepening economic integration which enhances competitiveness of East Asian economy. CEPEA should contribute to regional growth by taking concrete measures on further integration. At the same time, the undeniable reality is that there are serious gaps in the development levels among East Asian countries. Considering the economic diversity of East Asia, CEPEA should play a significant role as an integrated framework in narrowing such development gaps. To narrow development gaps among East Asian countries, and to build a basis for further development for each country, cooperative efforts should be taken among the countries. Economic cooperation to the less developed countries will also help solve the cross-regional issues, such as environmental problems, and thus lead to sustainable development of the region. Moreover, closer economic cooperation may also enhance intra-regional production and trade, and thus contribute to economic integration. With understanding that EAS is an enlarged East Asian region with great differences, it is feasible to make the economic cooperation as the priority and to start in the first place. Economic cooperation covers wide areas, from capacity building, human resource development, poverty elimination to transfers of technology, transfers of knowledge and improvement of infrastructure etc. Action oriented plans and programs with concrete commitments by East Asian members under CEPEA framework should be launched. CEPEA could establish working groups and task forces for designing and supervising the preparation and implementation. An important complement of the regional economic integration under CEPEA would be, for example, the creation of a structural fund. Considering that the economies in the region represent a to the less developed countries, in terms of linking highways, railways, ports, ICT connectivity or broadband connectivity or satellite connectivity, EDI/RFID, harmonization of customs and conformity procedures. And also, a regional development fund (RDF) is necessary. RDF could be earmarked for specific purposes such as uplifting poorer and backward regions of the member countries by investing in physical and social (education, training and healthcare) infrastructure, providing connectivity, rural and community development, enhancing agricultural productivity and development of agro-based industries, capacity-building, development of SMEs, providing subsidies, incentives and technical support and transfer of technology to producers based in these regions to enhance their competitiveness, and also providing social safety nets to vulnerable sections of society affected adversely by the regional trade liberalization, among other programs.
5. Considering the difficulty of the economic situation and the consensus building on how to realize an pan-regional FTA/EPA among East Asian countries, it is desirable for CEPEA to initiate a facilitation agreement starting with single window, mutual recognition of standards, harmonization of ROO, FDI promotion to less developed areas which may be considered as an EAFTA early harvest program which could cover several important areas such as transportation, tourism, movement of natural person, logistic and

energy/ environment. A stable business environment governed by transparent, predictable, streamlined and harmonized market rules is also necessary for economic development.

6. East Asia cooperation process should also encourage and support ASEAN to move further from current “ASEAN+FTA” structure to a larger regional FTA, i.e. to establish region wide FTA in East Asia in an early time. Currently, there are two proposals: one is EAFTA(ASEAN+3), another is CEPEA(East Asia Summit). The more feasible approach is to start from “ ASEAN +3 through a negotiation based on three “ASEAN+1”FTAs, and then to extend it to other EAS members, However, this needs political consensus among all members of the region. The rational choice for the region on a regional based FTA/EPA is to start from a smaller group, for example, from “ ASEAN+3”, and then to enlarge it to other members.
7. China will continue to initiate and participate in the regional arrangements. Aside from China-ASEAN FTA, China has strong interest to promote EAFTA and a broad cooperation agenda under the regional cooperation framework. As a member of EAS, China has strong interest to participate and support CEPEA since it can serve as a useful vehicle to enhance the enlarged East Asia cooperation process. China supports the CEPEA structure based on economic cooperation, facilitation of trade and investment and liberalization with FTA/EPA as the goal. As for the institutional building under EAS framework, it only can follow a soft approach, i.e. “function first”, rather than “institution first”. In so doing, CEPEA can be taken as a important process moving toward East Asia community building. As a large emerging economy in East Asia, China biggest contribution to the regional integration and cooperation process is to make its own economy continuously dynamic and sustainable. Facing the ever serious challenges from the global financial and economic crisis, China has taken active and positive steps to support and restructure its economic growth. East Asia region will benefit significantly if Chinese economy keeps open, dynamic and sustainable.

India

India

Nagesh Kumar

Research and information System for Developing Countries (RIS)¹

1. The Context

The external context for the CEPEA study group's work has dramatically changed since the completion of the Phase-I Report in June 2008. The US financial crisis that started as a sub-prime crisis in August 2007 has since snowballed into a crisis of unprecedented scale since the great depression of the 1930s. The advanced economies have slipped into deep recession. As per the IMF's *World Economic Outlook* (January 2009), the G-3 (or advanced economies) will be shrinking by 2% in 2009. There are downside risks of further deepening of the recession in the western world. The Asian and other developing economies have also been badly hit from the crisis. Not only has the recession in the western world squeezed the demand for goods and services they produce, the outflow of foreign institutional investments has badly affected the stock markets and currencies all across the region. The result is the crisis of confidence and the liquidity squeeze. Yet the emerging economies of Asia viz. China and India are still growing at relatively robust rates of growth of around 7 per cent. Their robust growth is thus helping the world economy avoid the threat of deep recession. The emergence of Asian region as the growth pole of the world economy has implications for the geography of economic relations. If the bulk of the growth stimulus in the next few years is to be coming from within Asia emerging economies, the regional economic integration in Asia assumes all the more relevance and urgency in the current context. There are also other implications for mutual cooperation in the regional context. For instance, the governments of the region are currently undertaking fiscal stimulus packages to revive the domestic demand to make up for the declining demand in the export markets. A coordinated strategy towards demand generation in the region may be more effective. Secondly, the crisis has helped focus attention on the long-pending reform of the international financial architecture. A coordinated position by EAS countries in the discussion on the reform such as those in the G-20 Summits would be more effective in getting their concerns addressed in the reform and in building an architecture sensitive to their needs.

In other words, Asian region has some real opportunities of further consolidation of their rapid growth and make it more sustainable by deepening regional economic integration. CEPEA should be designed as a framework for exploiting the opportunities for regional economic integration in a mutually beneficial manner for sustained growth of the member economies and narrow the development gaps. The three pillared approach recommended in the Phase-I covering Cooperation, Facilitation and Liberalization is most appropriate given the wide

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developmental gaps existing between the member countries. This approach of involving a fully blown economic cooperation pillar would also enable the CEPEA to differentiate itself from alternative proposals including the EAFTA. The Phase-II should elaborate on the scopes and coverage of the three pillars.

2. Economic Cooperation

An important objective of the schemes of regional economic integration schemes is to narrow the development gaps and bring about convergence in levels of economic development of different participants through most optimal deployment of region's resources. Balanced and equitable regional development also creates conditions for more enthusiastic participation of all partners including those lacking capacity in the schemes of regional economic integration. By now there is some evidence suggesting that increased trade by itself, even if balanced, does not ensure economic development, and needs to be accompanied by complementary development policies, including investment, especially in infrastructure and other public goods such as education and research and development, and regional and sectoral programs to assure balanced growth.² Globally the regional trading arrangements (RTAs) are being integrated with balanced regional development and social cohesion policies.³ Narrowing development gaps has been an important mandate for CEPEA from the EAS leaders. A very important indicator of the uniqueness and success of CEPEA as a scheme of regional economic cooperation and integration in East Asia would, therefore, be its ability to reduce the development gaps in the region and bring cohesion especially in view of very wide development gaps existing in the region.

Among the approaches to economic cooperation for narrowing development gaps include assisting poorer or lagging areas in the EAS countries to develop through capacity building and infrastructure development with the support provided by structural funds. The structural funds could be created by contributions by the member countries on the basis of capacity to pay. These funds should provide economic assistance to laggard regions within the member countries for capacity building, infrastructure development, assisting underprivileged sections of population and in adjustment with trade liberalization, improvement of connectivity and enterprise-level technological capability development.

In the context of the financial crisis, the challenge of the policy responses has been to augment the demand for goods and services to make up for the shortfall due to shrinking advanced economies. Thus the approach towards narrowing development gaps may be timely as it has the potential to enhance the aggregate demand by bringing poorer sections in the region to the

² Russell E. Smith (2005) Regional Integration in Historical Perspective: Nafta, Mercosul and the European Union: Discussion, <http://www.press.uillinois.edu/journals/irra/proceedings2005/smith.html>

³ See Nicola Yeats and Bob Deacon (2006) Globalism, Regionalism and Social Policy: Framing the debate, UNU/CRIS Occasional Papers # 0-2006/6; for a review of different RTAs.

mainstream. Therefore, the objective of narrowing development gaps has the potential of reviving the growth momentum in the region besides making it more balanced and equitable.

Furthermore, unlike in the past, the EAS region has resources in the form of substantial foreign exchange reserves of over US\$ 4 trillion to create an ambitious regional mechanism for funding infrastructure development and augment demand to mitigate the crisis besides offering balance of payment support. The proposals for productive deployment of the region's foreign exchange reserves have been discussed for some time. However, this has acquired a new relevance and urgency in the context of the financial crisis.⁴ CEPEA Study Group should consider the opportunities and come up with a report for the Economic Ministers and the leaders.

Another important area for cooperation is Macro-economic coordination. This is important in a regional context because the gains of trade liberalization may be nullified by exchange rate movements. Hence, CEPEA members may begin some macroeconomic policy coordination. For this an annual dialogue of Finance Ministers and Central Bank Governors would be important. The other initiatives could include creation of an Asian Currency Unit as a unit of account to facilitate intra-regional trade and production networking by enhancing relative stability of exchange rates for mutual trade.

Cooperation in the area of energy security including transfer of energy conservation techniques and other environmentally sensitive technologies across the region, development of transport infrastructure and connectivity, harnessing the fruits of new core technologies for addressing the digital divide and nutritional and health related issues as well as a coordinated position in global economic governance could be other areas of economic cooperation within CEPEA framework.

⁴ See for instance RIS Discussion Paper # 31 proposing a regional financial institution that could assist the region in intermediating between rising foreign exchange reserves of East Asia that now exceed US\$ 4 trillion, and growing infrastructure deficits in the region. In the absence of a regional mechanism for their deployment, these reserves have to be invested in the US treasury bonds earning very low returns and contributing to global imbalances. A regional mechanism can be created with an authorized capital of US\$ 300 billion, 10% of which may be paid up. This regional mechanism will borrow from the central banks of the East Asian countries at the rate applicable on 30 year US Treasury Bills. Besides lending to regional infrastructure projects, this institution may also be able to provide some viability gap funding to eligible projects out of the surpluses earned through active management of funds at its disposal in equity indices across the world. The institution could spur the infrastructure development activity, especially cross-country connectivity, in the region by providing lending and viability gap funding without drawing upon the budgetary support of the member governments. It could also provide non-financial assistance to catalyze infrastructure projects in the region such as by identifying and formulating projects, and providing advice and assistance to the government, private sector and other donor agencies. It is debatable whether such a mechanism could be an adjunct to the existing institutions, such as Asian Development Bank, or be set up as a separate institution.

3. Facilitation

The objective of trade and investment facilitation should be to harmonize the customs procedures and to evolve a possible single window for intra-CEPEA trade. Another aspect is to organize CEPEA Trade Fairs to facilitate exchange of trade information and develop business contacts. CEPEA Trade Fairs could rotate across the 16 members and could be both general purpose as well as for specific industries. The trade promotion and trade financing organizations (such as export-import banks) of CEPEA countries could form their respective regional bodies to cooperate and develop region-wide programmes. The export-import banks of Asian countries have been interacting with each other for some time. Hence, a regional association could be given effect without much effort. Yet another important facilitation measure will be to create a regional unit of account (viz. an Asian Currency Unit) based on a basket of region's currencies to conduct mutual trade.

4. Liberalization

CEPEA could target to liberalize regional trade and investment regimes in a phased manner by 2020. The objective should be to create a unified or seamless market of the 16 EAS countries. With roughly half of the world's population and some of the most dynamic emerging markets such as China and India besides the second largest economy of the world namely Japan, CEPEA would become a centre of gravity of the world economy in a short while.

CEPEA could evolve a regional framework for liberalization of trade in goods and services and investment flows between the members. A scheme of trade and investment liberalization covering some highly advanced countries such as Japan, Australia, New Zealand and South Korea (all OECD members), middle income countries such as Singapore, Malaysia, developing countries such as the Philippines, Indonesia, China and India, and the least developed countries such as Cambodia, Laos, Myanmar will have to be necessarily a gradual one in view of the need for incorporating special and differential treatment provisions for lesser developed economies to give them time to build capabilities to take advantage of the trade liberalization. Notwithstanding the fact that CEPEA may begin with a rather different coverage and scope of trade liberalization of members with different abilities, CEPEA could add value to existing ASEAN and dialogue partners FTAs network in a number of ways. Firstly by providing a unified or seamless market with harmonized and cumulative rules of origin and thus avoiding the noodle bowl syndrome. Secondly it would provide preferential trading environment for the first time to the mutual trade between a number of dialogue partners such as China, Japan and South Korea as between China and India among others.

Besides provisions for special and differential treatment for countries at different levels of development, CEPEA should provide safeguards for sensitive products and for dispute resolution. Care must be taken in designing the programmes of regional economic integration in

such a manner that they keep equity, employment generation and industrial development at their heart to make it regionalism with an 'Asian Face'.

5. Institutional Development

Deepening the regional economic integration will require a number of institutions. Some of these have been mentioned in the foregoing. These include:

- A CEPEA Secretariat: To coordinate the programmes of regional economic cooperation and integration and monitor them, a secretariat would be important.
- ERIA: ERIA should emerge as a regional policy think-tank. It should build analytical capability in conjunction with the national think-tanks and begin assisting the process of regional cooperation in EAS region much in the same way as OECD. It should also coordinate with other regional organizations such as ADB, UN-ESCAP and their subsidiary bodies.
- Regional Mechanism for Financial Cooperation and Infrastructural Development: As discussed above, a mechanism would be important for intermediating the foreign exchange reserves and growing infrastructure requirements in the region. It is debatable whether this arrangement can be an adjunct to the existing institutions such as the ADB.
- Regional Associations of Trade Promotion Bodies of EAS countries
- Regional Association of Trade Financing Institutions and EXIM Banks of EAS countries
- Annual Meetings of Finance Ministers and Central Bank Governors to discuss macroeconomic issues and responses to reform of international financial architecture. This would complement the Economic Ministers Meetings of EAS.
- Creating EAS programmes at the existing regional institutions such as Asian Institute of Technology (Bangkok), Asian Institute of Management (Manila), Asian College of Journalism (Chennai), among many others.

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1. Introduction

As we came to an agreement during the Phase I Study, CEPEA's objectives should be narrowing development gaps, deepening economic integration, and achieving sustainable development. Although our discussion will primarily focus on this point of view, we should also pay closer attention to the current economic situation in this region. Worldwide financial crisis in 2008 revealed weaknesses and instability of the East Asian economy and made us recognize that regional initiatives are indispensable for providing a solid basis for economic development for the long term.

It was once believed that the financial crisis in the United States could not affect the East Asian economy and East Asia would keep developing. Increased trade and investment in Asia has expanded cross-border production network within the region, and firmer connections in the region have made people believe that Asia's economic network has become self-reliant and less dependent to other major economies. In reality, Asia's high dependency on exports to the US market in the manufacturing sector has not changed over the years, even though intra-regional trade in East Asia seemed expanding. As it has become increasingly clear, the economic crisis in the United States surely has affected the East Asian economy. Savings in Asia today still remain at a high level. Many researchers have suggested that domestic demand in East Asia should be expanded, in order to circulate these savings into the real economy. Meanwhile, others suggest that social security net or social infrastructure should be developed, so that the East Asian people can increase their consumption, rather than saving for their future.

Besides the financial issues, energy, environment and food issues can threaten sustainable development in the region. Such region-wide issues can be a focus of the CEPEA study.

2. Economic Cooperation

One important agenda of economic cooperation under CEPEA is to narrow development gaps in the region. Considering existing gaps, the possible cooperation agenda under CEPEA may include strengthening small and medium enterprises (SMEs), enhancing logistics infrastructure, developing ICT infrastructure and human resource development. Also, it should be noted that there are many existing cooperation projects and that coordination is needed with cooperation through other frameworks.

a) SMEs

To deepen economic integration and narrow development gaps in the region simultaneously, SMEs of the ASEAN+6 countries including less developed economies play an important role if they can be integrated into the regional production network. Integration into such networks would lead to strengthening competitiveness of less developed economies' industry. The participation of less developed economies into the production network needs to be promoted through capacity building and development of supporting industries. It could cover training in manufacturing skills or manufacturing process management including quality management or cost management.

b) Infrastructure

Infrastructure development, especially in logistics is essential in streamlining and increasing transactions within the region. The connectivity of each country should be improved through infrastructure such as roads, seaports and airports, especially in the less developed region. Development of such infrastructure will contribute to regional integration and strengthening industries in the region including supporting ones in the less developed economies.

c) ICT

ICT development is useful to enhance business linkages, and can facilitate trade and investment in the region. It can be used in a broad range of areas, such as logistics, manufacturing, services (including e-commerce), public administration, information sharing, training, etc.

d) Human resource development (HRD)

Needless to say, human resource development is one of the most important components of the cooperation projects as human resource is the very basis of development in each industrial sector. As HRD involve all sectors, it may overlap with cooperation in the previously mentioned areas. HRD also provide a basis for facilitation and liberalization of trade and investment. It could lead to deepening understandings among the public/private sectors, improving technological expertise, and increasing industry-academia R&D partnerships, etc.

While economic cooperation under CEPEA is essential for narrowing development gaps in the region and building a basis for further development in each country, cooperation has other important functions that are to prepare solutions to the region-wide crisis and to stabilize the region by strengthening linkages in the region. Especially, the current economic crisis requires countries in the region to maintain and deepen closer relationship and partnership.

The financial turmoil and economic situation have brought countries to discuss financial cooperative policy by broader members including less developed economies to overcome the crisis. As CEPEA consists of a wide membership, the member governments can contribute to stabilizing the macro-economy in the region through financial cooperation.

There are some other issues to be looked into, for achieving sustainable development in the region. The shortage of natural resources and the price hike of raw materials are among such issues. For instance, the drought in Australia in 2008 caused limited production of wheat, which resulted in the sales price increase of flours and related foodstuff in the importing countries. ASEAN has been responding to the recent concern on supply and demand in food and agricultural products. The member states developed a comprehensive “ASEAN Integrated Food Security (AIFS) Framework” and “Strategic Plan of Action on Food Security in the ASEAN Region 2009-2013”. According to AIFS Framework, its goal is to ensure long-term food security and to improve livelihoods of farmers in the ASEAN region. Action plans are comprehensive, ranging from development of regional food security reserve initiatives to industry development and improving market access. Such sub-regional approaches can be extended to cover the whole East Asia.

3. Facilitation of Trade and Investment

There are many trade and investment facilitation measures already in place in the region, ranging from improving customs efficiency, transport infrastructure, implementation process, IPRs, investment protection, government procurement, and so on. There can be many kinds of initiatives to reduce transaction costs of cross border trade and investment and to remove barriers to intra-regional business. While a range of facilitation measures is broad, rules of origin issue can be pointed out as one of the most important issues.

Of course, the rules of origin (ROO) always occupy the central place among the issues arising during FTA/EPA negotiations. Even if we don't think about a newly negotiated FTA/EPA, ROO still remains as a serious problem as existence of many bilateral FTA/EPAs in the region has been said to result in the so-called 'spaghetti bowl' phenomenon. We have to pay close attention to the characteristics of the 'spaghetti bowl' phenomenon and consider how to overcome it.

First of all, the meaning of the 'spaghetti bowl' phenomenon must be clarified. Existence of a variety of rules for each sector within one FTA/EPA can be burdensome for exporters. Difference of procedures for issuance of certificate of origin between agreements may trouble exporters. Also, applied tariff rates differ depending on which FTA/EPA the exporter invokes.

Such complication of a bundle of FTA/EPA may affect the exporters, especially small and medium enterprises, by increasing procedural cost. Exporters may face questions as to how best to utilize FTA/EPAs. They also have to analyze and determine which case is most suitable for invoking FTA/EPAs.

Various ROO rules are applied to products under each FTA/EPA. For example, Change in Tariff Classification (CTC) rule is applied to some products while some other products are evaluated whether they can be qualified as originating products by Regional Value Content (RVC) rule. Some ASEAN+1 FTA/EPAs allow exporters choose either CTC or RVC rule while some require exporters to establish that their products are regarded as originating goods under both CTC and RVC rule. This complexity seems the result of sensitivity of each country as countries tend to choose stricter rule for products sensitive to them. Applying such strict rules, a country can avoid circumvention through an FTA/EPA from the third party.

Procedures for issuance of certificate of origin also vary. Requirements for documents such as the price of exported products to be included in application may differ from agreements to agreements.

Exporters have to gather and store such information on their products and determine whether use of FTA/EPA is beneficial for them. More specifically, exporters have to assess whether cost to use FTA/EPAs is less than the benefit from eliminated tariff rates and thus the use of the FTA/EPA is beneficial for them. Especially for small and medium enterprises, gathering such procedural information and assessing whether they should use FTA/EPA may cause burdensome cost to them.

In order to resolve these problems, following actions are conceivable;

- i) to harmonize ROO in each FTA/EPA as far as possible,
- ii) to harmonize procedures for issuance of certificate of origin,
- iii) to gather and provide information on FTA/EPA to exporters in the region.

These actions can contribute to the mitigation of the 'spaghetti bowl' situation and as a result

facilitate trade and investment in the region. Phase II Study should focus on this point as an agenda for the continuing study.

4. Liberalization of Trade and Investment

While cooperation and facilitation measures under CEPEA will contribute to the region in many aspects, liberalization of trade and investment through the region-wide FTA/EPA would bring out various additional values for the countries within the region.

First, the new region-wide FTA/EPA creates virtually new bilateral FTA/EPAs between two countries where there currently exist no FTA/EPAs. Sometimes bilateral negotiation does not proceed smoothly because of sensitivity in some sectors. Although negotiations among many countries are not usually concluded easily, in some cases countries may gain enough benefit from other participating countries so that they can persuade the sensitive sectors in their countries into supporting the conclusion of the FTA/EPA.

The benefits from such ‘creation of the new bilateral FTA/EPAs’ are not limited to the two countries but also extend to the third countries whose companies have developed supply chain network which covers the areas where the ‘new FTA/EPA’ is created. The supply chain network can become more efficient through reduced transaction cost in areas such as tariffs. Furthermore, the countries which enjoy less direct benefit from trade liberalization because of their less competitiveness in some sectors can also benefit from the FDI growth. Companies in the region may choose such countries as location of their production sites because flexibility for choosing production sites increases after trade barriers are eliminated through liberalization.

One of other important values comes from applying accumulation of the rules of origin within the region. The products which are produced from material to final products through multiple countries and cannot meet the rules of origin under bilateral FTA/EPAs can be qualified as originated products under accumulation rule in a plurilateral FTA/EPA.

In Phase II study, it will be worth discussing the benefits of liberalization to each country from these perspectives and clarify what is an actual meaning of liberalization under CEPEA.

5. Institutional Development

While cooperation between ASEAN+6 countries has intensified since the inception of the East Asia Summit (EAS) in 2006, the characteristic of EAS remains ‘a leaders’-led Summit for strategic discussions on key issues’ as identified in Chairman’s Statement of the first EAS.

On the other hand, it can be argued that some institutional arrangements are necessary for ASEAN+6 framework in order to implement various measures under the three pillars of CEPEA, namely cooperation, facilitation and liberalization. There would be various arguments on the characteristic of ASEAN+6 and ways to develop institutional arrangements in the region. In this paper, we give consideration to what kind of functions is needed to implement measures under CEPEA and thus what kind of institutional arrangements should be developed.

a) Cooperation

In this region, we have launched many region-wide initiatives for economic cooperation. However, some problems can be pointed out. Some of the initiatives may be conducted individually without coordinated each other and thus there would be room to eliminate duplication and waste or give appropriate priority to urgent ones. Also, we lack a sufficient mechanism to review and evaluate ongoing and finished projects. Necessary functions to solve these problems can be summarized as follows: depicting a grand design for cooperation in each sector, deciding areas to set higher priority, coordinating each country's cooperation policy, monitoring implementation of each initiative, and assessing the effects of the completed projects.

b) Facilitation

The same issues as those pointed out for cooperation measures could basically apply to facilitation measures. Processes to arrange and monitor various facilitation measures in the region should be developed. Such coordinating processes for facilitation measures may be more important than for cooperation since facilitation measures, for example, operating the AEO (Authorized Economic Operator) system in a unified way throughout the region, require coordination with each country's domestic policy and regulation.

c) Liberalization

It requires an enormous quantity of in-depth discussion to negotiate and conclude an FTA/EPA, especially in the case of negotiation in which many participating countries are involved. The negotiating processes of concluded ASEAN+1 FTAs have exactly been a case in point. In order to conduct effective discussions and streamline the negotiations, countries must organize negotiating process in a suitable manner. Additionally, under an effective FTA/EPA, various committees are held in order to discuss issues related to implementation of

it. These processes may need some institutional arrangements to smooth discussions among 16 participating countries.

In addition to the above functions contributing to the CEPEA's three pillars, it can be beneficial to think about the institutional functions for a comprehensive discussion on region-wide issues, such as how to address the current global economic crisis, formulation of a concrete action plan, and implementation of it. Although there are frameworks under which Leaders and Ministers of ASEAN+6 countries discuss various region-wide issues, it can be useful to develop such frameworks to deepen coordination of countries' policies.

To cite the case of ASEAN, various Ministerial and working-level meetings are organized besides Leaders' meetings, and ASEAN Secretariat has played a considerable role in coordination among the member countries, and as a result, ASEAN has made major progress in regional integration, such as the establishment of AFTA, the implementation of ASEAN charter, and so on.

ASEAN+3 has developed regional cooperation framework since its inception. Since the financial crisis in 1997, ASEAN+3 has been working on economic cooperation projects, especially on financial cooperation. With this example, CEPEA can start working on regional cooperation such as energy, food security and environment issues.

Following these examples, it is worth considering developing various Ministerial and working-level meetings and secretariat's functions for the ASEAN+6 framework. There are already some regional institutions in East Asia, such as ASEAN Secretariat. ADB and ERIA might be added to the examples of such institutions. It is an attractive option to utilize such institutions typified by ASEAN Secretariat and expand the functions of them in order to avoid any unnecessary overlap, and maximize the benefit from limited resources.

Malaysia

Malaysia

Merlyn Kasimir

Overview

1. The Phase I Report of the Track Two Study Group on CEPEA should be the basis for further work on detailing the pillars of economic cooperation, facilitation and liberalisation, as well as institutional developments. We should build on the proposals made in the report. As it will not be realistic to implement all the proposals simultaneously, there has to be some element of prioritisation. While the CEPEA Report points out that none of the three pillars can be left out in pursuing the objectives of CEPEA, it is also stated that it “does not mean that each measure must proceed simultaneously”

2. Economic cooperation and programmes can help narrow development gaps in the region , and also build capacity and capabilities for the effective and meaningful implementation of facilitation and liberalisation measures under CEPEA. Some of the less difficult or less “sensitive” facilitation areas could also start earlier as building blocks towards dealing with other facilitation proposals, and the longer term objective of a region- wide FTA

1. Economic Cooperation

3. The cooperation initiatives and programmes outlined in the Phase I report are intended to help narrow the development gaps and build capacities for implementation of facilitation and liberalisation measures. The proposal on **structural funds** for regional development, while may be attractive, needs further study and evaluation, particularly in coordination with the role and the scope of programmes of existing regional organisations such as the ADB .

4. The development of ‘hard’ and ‘soft’ infrastructure play a vital role in facilitating trade , lowering transactions costs and expanding linkages to the regional supply chain and production networks. **Adequate and efficient logistics infrastructure and services** in the region can support and strengthen the regional supply and production chains. The logistics requirements are becoming more demanding and sophisticated with the expansion and strengthening of production networks and supply chains . Therefore **cooperation programmes and initiatives in the area of logistics- related hard and soft infrastructure** should be given due importance as it will help facilitate trade , as well as promote economic growth and international competitiveness of countries.

5. In this connection the **related areas for cooperation** could include:

- port infrastructure and services development, as well as improvements in port efficiency and security;
- improving the capacity of the logistics industry in the region , such as through strategic partnerships and technical collaborations , so as to enhance their participation in the regional supply chain and production networks;
- automating logistics processes and providing an integrated end-to-end fulfilment and supply chain management;
- assistance in the utilisation of ICT in supply chain management and application of new technologies , such as RFID;
- development of the National Single Windows and electronic transactions;

6. In **the area of ICT**, as outlined in the Report of the Track Two Study Group on CEPEA, economic and technical cooperation **measures, should cover** the following areas:

- Harmonisation of policies, laws and Mutual recognition in E-Commerce
- Work towards common technical specifications and standards for ICT infrastructure to ensure interoperability of systems and networks. Technical and financial assistance for the establishment of suitable ICT infrastructure
- Support the development of e-logistics in the region
- Capacity building programmes for personnel of the less developed economies , and SMEs to improve efficiency

7. There is a need to develop suitable cooperation programmes that can help enhance the **capacity and competitiveness of small and medium enterprises (SMEs)** in the region so that they can also effectively participate in the regional production networks and supply chains. **Some of the areas include:**

- Adoption and application of latest technologies , including ICT , for product and process improvements and product innovation, including HRD programmes to equip SMEs to apply such technologies;
- Adherence to international environmental standards and requirements through adoption of environment-friendly technologies and practices;
- Conformance to standards and certifications, including adoption of good manufacturing practices.
-

2. Facilitation of Trade and Investment

8. In the area of facilitation of trade the focus could be on programmes that can reduce obstacles to trade, and reduce business transactions costs. The facilitation areas in trade could be ‘building

blocks' for the longer term objective of a region-wide FTA. In the implementation of facilitation measures it is also useful to bear in mind the development gaps among the CEPEA countries. Thus capacity building has to be an integral part of the facilitation programmes.

9. The measures outlined in the ASEAN Economic Community Blueprint(AEC) on facilitation could provide a basis for facilitation cooperation in CEPEA. The areas for facilitation could include:

- Implementing a trade facilitation programme aimed at harmonizing and standardising trade and customs processes , procedures and related information flows;
- Adoption of standards and practices to secure a uniform system of tariff classification, and a synchronised system of customs valuation;
- Building on the ASEAN Single window initiative to establish the **East Asia Single Window**. This will help expedite customs clearance, reduce transaction time and costs and improve trade efficiency;
- Harmonisation of standards, technical regulations and conformity assessment procedures using international standards and practices as benchmarks;
Mutual Recognition Agreements (MRAs) of conformity assessment for specific sectors, and MRAs on professional qualifications to enhance services trade. In this connection there would be need for technical support and capacity building to enhance 'soft-infrastructure' for conformity assessment and compliance.

3. Liberalization of Trade and Investment

10. A challenge faced by Malaysia, and probably a number of countries in the region , is resource constraint , particularly with regards to manpower and skills requirements for FTA negotiations, implementation, administration ,monitoring and also for assisting/advising exporters on the effective utilization of concessions under the FTAs.

11. The other challenges include:

- Balancing the need to gain market access for exporters and the interests of domestic industries and businesses that may be affected by concessions offered under the FTAs;
- Pursuing market liberalization while ensuring that national development goals and objectives are not sacrificed;
- Ensuring that SMEs benefit from trade liberalization under the FTAs through the building of capacity and strengthening of SMEs so as to facilitate their integration and participation in the regional supply and production chains ;
- An important contribution to the negotiating process would be consultations and inputs from trade and industry associations. However, many of such organizations in Malaysia do not have the capacity and they lack the expertise and resources to effectively represent the interests of their respective industry sectors;

- The securing of support and effective dissemination of information on FTAs to relevant stakeholders such as trade and industry associations, as well as influential groups such as members of Parliament and NGOs.

12. A region-wide FTA may be an ideal option to addressing the “spaghetti bowl” effects of the varying and multiple ROOs, and the issue of regional cumulative rules of origin. However, a **realistic, sequential and “ confidence building” approach should be adopted towards the realization of a region-wide FTA** – either through the ambitious task of consolidating all the five ASEAN+1 FTAs, or concluding a new FTA involving the 16 countries, or starting first with a ASEAN +3 FTA. **A region wide FTA should thus be seen as a longer term objective, with the focus initially on cooperation programmes (to strengthen capacity and narrow development gaps), and measures for facilitating trade and investment.**

13. It would be **logical and appropriate to first implement all the five ASEAN +1 FTAs and assess the progress, implementation issues, and impact** of the FTAs on liberalization, businesses, and on economic integration. This will **provide a good basis for moving forward.**

14. In this connection the **Study Group could do further work on areas such as:**

- A **comparative analysis of the ASEAN +1 FTAs** (including individual country schedules) relating to areas like the coverage of products, depth of tariff cuts, the varying modalities and timeframe for implementation of concessions, the scope of the exclusion list (for ‘sensitive’ and ‘highly sensitive list’), and other tariff and NTBs that have not been addressed;
- **Feedback from businesses** in the region on the utilization of the FTAs, main limitations/obstacles, the benefits of the FTAs, and the problems of the multiple and varying ROOs. The enterprise level surveys undertaken in some countries by the ADB Institute and JETRO could also be utilized as inputs.

(According to the JETRO 2007 Survey of Japanese-affiliated companies in ASEAN, more than 50% of the firms surveyed in Malaysia had indicated that they have no plans to utilize FTAs. The main reason given by more than half of these companies was that the parties to which the goods are exported are exempt from import duties (as part of package of investment incentives), and 32% stated that there are no real benefits of the FTA as the MFN tariffs are generally already low)

- **Comparison of the varying and differing ROOs** in the each of the FTAs and across the 5 ASEAN + 1 FTAs, and the other bilateral FTAs among countries in the region
- Study the **extent to which the harmonization of the ROOs can be achieved.** It would no doubt be a challenging task considering that the different provisions for determining origin in the FTAs, including the product specific rules, are intended to address the different domestic industry concerns of the countries. Some are in fact said to be quite protective in nature.

- An **intermediate step towards a region-wide FTA** could be to initiate efforts on rationalizing the varying ROOs in the FTAs in the region towards achieving some degree of similarity or convergence in the ROO regimes

4. Institutional Development

15. Some mechanism would be required to coordinate and provide support for the implementation of the programmes and initiatives under CEPEA. Further thought and work would have to be required on the question of institutional development and **the options may include:**

- Establishment of a “cooperation office” under the framework of the ASEAN Secretariat . This would be in line with ASEAN’s role as the driving force for economic integration in the region.
- The evolution of ERIA into an OECD-type organization
- The establishment of a CEPEA secretariat under the auspices of EAS

Myanmar

Myanmar

Daw Win Myint
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1. Introduction

In Phase I Study, the objective of CEPEA should be narrowing development gaps, deepening economic integration, and achieving sustainable development. To achieve the objectives of CEPEA, there are three main pillars of economic cooperation, facilitation and liberalization of trade and investment, as well as institutional development. We should emphasis these pillars on the proposal.

However, it is impossible to implement all three pillars simultaneously, we need to pay attention some elements of prioritization. Among three pillars, economic co-operation can achieve narrow development gaps in the region, and build capacity and capabilities for the effective facilitation and liberalization of trade and investment. Moreover, admist of financial crisis, economic cooperation and partnership are vital elements for sustainable development.

2. Economic Operation

Economic operation measures can assist the development of hard and soft infrastructure which is a key foundation of trade facilitation, reducing transaction cost and enhancing linkages between the countries. The study should focus on these areas of cooperation where it is likely to gain the most value-added activities in the region, there should be effective networks which lead to strengthening competitiveness of less developed countries industry. Therefore, it should be development funds for SMEs development to link the regional development. In addition, ASEAN plus 6 countries should deepen shift from bilateral economic partnership to region wide economic integration such as multilateral style of integration on ASEAN, ASEAN plus 1, ASEAN plus 3, ASEAN plus 6and APEC.

3. Facilitation and Liberalization of Trade and Investment

To facilitate the trade and investment in the region, there should be such programme that can reduce obstacles to trade and reduce transaction costs. The measures should ranging from improving custom efficiency, harmonizing and standardizing trade and custom procedures. Moreover mutual recognition agreements for services sector can enhance services trade. There would be need for enhancements of soft infrastructure for conformity assessment and compliance.

FTA/EPA under CEPEA should pay close attention to ROO which may be serious problem in the region like spaghetti bowl phenomenon. These study should consider how to overcome the phenomenon. In order to resolve these problems, there need to harmonize procedures for issuing certificate for ROO and todissiminate FTA to players in the supply chain in the region.

4. Institutional Development

There should be some institutional arrangements which are ingredients of CEPEA in order to implement three main pillars. It would be a desk under the frame work of the ASEAN secretariat to monitor and evaluate the functions of three pillars effectively and efficiently.

New Zealand

New Zealand

Brent Layton
New Zealand Institute of Economic Research

Building the pillars of a regional economic partnership agreement

1. Preface

NZIER is a specialist consulting firm that uses applied economic research and analysis to provide a wide range of strategic advice to clients in the public and private sectors, throughout New Zealand and Australia, and further afield.

NZIER is also known for its long-established Quarterly Survey of Business Opinion and Quarterly Predictions.

Our aim is to be the premier centre of applied economic research in New Zealand. We pride ourselves on our reputation for independence and delivering quality analysis in the right form, and at the right time, for our clients. We ensure quality through teamwork on individual projects, critical review at internal seminars, and by peer review at various stages through a project by a senior staff member otherwise not involved in the project.

NZIER was established in 1958.

2. Authorship

This report has been prepared at NZIER by John Ballingall and reviewed by Brent Layton. The assistance of Professors Shujiro Urata of Waseda University and Mitsuyo Ando of Keio University on modelling matters is gratefully acknowledged.

The views in this report are those of the authors and do not necessarily reflect the views of the New Zealand government.

Executive summary

1. Background

The Track II Study Group on a Comprehensive Economic Partnership in East Asia (CEPEA) released its Phase I report in 2008 on the desirability of further regional integration amongst East Asia Summit countries. It recommended as an option further Track II research into the three ‘pillars’ of a CEPEA: economic cooperation, facilitation of trade and investment and liberalisation of trade and investment. East Asia Summit Economic Ministers endorsed this further Track II research in August 2008 and asked that institutional development necessary to support a CEPEA be added to the research agenda.

Based on the outcomes of the December 2008 Ad Hoc Meeting of the Study Group in Tokyo, the Chair invited country experts to submit in early 2009 a detailed paper on one or more of the topics above. This report is the New Zealand expert’s response to this invitation.

2. Objectives of research

This report builds on, and explores new ground related to, the three pillars of a CEPEA noted above, plus institutions, and deepens the analytical knowledge base for future discussions.

It aims to inform and focus Study Group discussions for the next phase of this initiative by:

- Making specific suggestions on the nature and scope of provisions that fall under the various pillars of CEPEA. These suggestions add some “meat on the bones” of the conceptual framework presented in the Phase I report and move discussions towards considering the optimal design of a CEPEA.
- Updating the general equilibrium modelling exercise in the initial report by employing the recently-released version 7 of the GTAP database. This analysis estimates separately the impacts of a CEPEA on 15 of the 16 East Asia Summit countries, including Cambodia, Laos and Myanmar (which were not analysed separately in the Stage I report modelling)
- Identifying areas of future research for the Study Group to consider.

3. Approach

We examine the vast and ever-expanding international literature (including from the OECD, ADB, APEC) on trade liberalisation, regional trading agreements and deeper economic integration to determine some best practice guidelines for designing liberalisation, cooperation and trade facilitation measures under a CEPEA.

We undertake a computable equilibrium modelling exercise to estimate the potential benefits from a comprehensive CEPEA that is designed along the best principles outlined above.

Based in this review of literature and modelling exercise, we put forward some conclusions regarding the optimal design of a CEPEA and make some recommendations for further research.

4. Conclusions

Given the intra-East Asia liberalisation witnessed to date, and the potential costs of the region continuing to go down the “hub and spoke” route outlined in section 3.1, this study concludes that there is a clear case for the introduction of a more coordinated approach to regional economic integration through a CEPEA that:

- Improves the efficiency of resource allocation within the region to the benefit of firms and households via improved profitability and higher per capita incomes.
- Enhances rather than hinders the development of regional production networks.
- Provides for deeper regional engagement than a simple tariffs-only agreement through increased facilitation and technical assistance activities.
- Does not act as a ‘stumbling block’ to future multilateral liberalisation.

Such integration must be based on economic principles, rather than on political foundations. A CEPEA must avoid becoming “trade-light” or “PTA-lite” due to not being driven by economics.

In the present economic environment, there is ample justification for taking bold steps to progress regional integration: the very last thing countries should be doing right now is becoming more inward-looking. Most firms and households in East Asia will recognise this fact, despite the traditional pockets of resistance. This should provide considerable impetus to political leaders’ efforts to implement a CEPEA.

In considering the optimal design for a CEPEA, based on the three pillars identified in the Phase I report (liberalisation, facilitation and cooperation) as well as institutions, our

report has suggested some key principles. These principles have been developed based on the international literature on PTAs, commonly-accepted best practice guidelines from international agencies and economic modelling. The key implications from our analysis include:

1. A comprehensive, high quality and ambitious CEPEA should be approached as a 'single undertaking'. It is not sufficient to solely consider goods liberalisation. A CEPEA must also include substantial services and investment liberalisation so that East Asian countries can better exploit their comparative and competitive advantages and to reallocate resources in a more efficient manner.
2. A CEPEA will deliver the greatest benefits when it covers a larger number of countries and does not exclude any sectors from liberalisation. Levels of ambition under a CEPEA should therefore remain high.
3. A CEPEA should contain provisions on government procurement, competition policy and intellectual property. Such provisions help to lock in the benefits of trade liberalisation. While these are sometimes contentious issues, and their exact form can be debated, they should remain 'on the table' for negotiators to discuss.
4. The differing development levels of potential CEPEA members must be acknowledged. However, given that a large proportion of the benefits from trade liberalisation are generated by domestic reallocation of resources and regulatory reform, deeper economic integration provides the best opportunity for closing existing development gaps within East Asia.
5. The gains from a comprehensive CEPEA that incorporates trade facilitation and technical assistance provisions are estimated to be far greater than those estimated for an agreement that covers tariff liberalisation only. Therefore trade facilitation and cooperation must be considered in addition to (not in lieu of) trade liberalisation.
6. Cooperation activities under a CEPEA should involve knowledge transfer and information sharing on issues of mutual interest amongst members. Important areas of cooperation could include agricultural technology, environmental and energy issues, financial cooperation and assisting small and medium enterprises. Cooperation could also include training on using analytical tools such as computable general equilibrium modelling to assess and disseminate the benefits and adjustments costs of a CEPEA. All cooperation activities should be centred on improving resource allocation to enhance the ability of members to harness the potential economic and development benefits arising from deeper regional economic integration.

7. A key focus of CEPEA trade facilitation activities should be simplifying border procedures. This will reduce the transaction costs of trading activities, which will improve economic outcomes for businesses and consumers alike through improved profitability and lower prices respectively. Of particular importance are customs procedures and the way in which standards (TBT and SPS) are applied.
8. The nature of ROO under a CEPEA negotiation will be crucial to ensuring that intra-CEPEA trade flows are boosted after liberalisation. ROO should ensure that trade deflection is minimised and that intra-CEPEA trade is facilitated. ROO must not be used as a form of protection in disguise, or the gains from integration could be undermined.
9. When combined, liberalisation, facilitation and cooperation/assistance spur enhanced and more efficient regional production networks and encourage dynamic gains and technology transfer that can deliver improved productivity growth rates. These three pillars can also generate higher levels of investment that are important for developing infrastructure.
10. Existing regional institutions such as the East Asia Summit, the ADB and ERIA provide a sound foundation for driving, coordinating, implementing and monitoring progress under CEPEA. An additional institution of modest size may be required in the form of a CEPEA Secretariat to monitor progress and co-ordinate efforts.

1. Background

In June 2008 the Track II Study Group on a Comprehensive Economic Partnership in East Asia (CEPEA) released its report on the desirability of further regional integration amongst East Asia Summit countries. The recommendations of this report included the option of commissioning further Track II research into the three ‘pillars’ of a CEPEA:

1. Economic cooperation
2. Facilitation of trade and investment
3. Liberalisation of trade and investment

East Asia Summit Economic Ministers endorsed this further Track II research in August 2008. Ministers asked that any institutional development necessary to support CEPEA be an additional area of research interest for this further work.

Based on the outcomes of the December 2008 Ad Hoc Meeting of the Study Group in Tokyo, the Chair invited country experts to submit by the end of January 2009 a detailed paper on one or more of the topics above. This report is the New Zealand expert’s response to this invitation.

2. Objectives of report

The Phase I CEPEA Study Group report presented an overview of CEPEA’s objectives and scope, estimated the economic impact of a comprehensive agreement and provided some high level suggestions regarding selected key elements of such an agreement. This report builds on, and explores new ground, related to the four pillars of CEPEA noted above, and deepens the analytical knowledge base for future discussions.

This report aims to inform and focus Study Group discussions for the next phase of this initiative by:

1. Making specific suggestions on the nature and scope of provisions that fall under the various pillars of CEPEA. These suggestions add some “meat on the bones” of the conceptual framework presented in the Phase I report. This will help the Study Group to develop a view on what a CEPEA could look like in practice, and to better understand some of the complex issues and trade-offs that will arise if a comprehensive agreement is to be negotiated.

2. Updating the general equilibrium modelling exercise in the initial report by employing the recently-released version 7 of the GTAP database. This analysis estimates separately the impacts of a CEPEA on 15 of the 16 East Asia Summit countries.¹ This modelling update will provide researchers, policy makers and Ministers with a clearer sense of the potential benefits that CEPEA would deliver to member countries.
3. Identifying areas of future research for the Study Group to consider.

3. Context

3.1 East Asian regionalisation to date

The history of East Asian regionalisation is fairly outward-looking (Sally, 2009). Unilateral liberalisation in East Asia, particularly in the 1980s by Asian ‘Tigers’, has resulted in the development of regional production networks (through lower import and inward investment barriers) as capital-intensive countries seek to utilise the vast pools of relatively cheap labour available in nearby economies. In particular, East Asian countries’ desire to become closely linked into China’s production networks has triggered further unilateral liberalisation.

But this unilateral liberalisation has been patchy across sectors and isn’t bound, meaning that previously removed barriers could be re-imposed at will. As such, unilateral actions cannot be relied upon to provide the certainty required to move regional integration forward for the benefit of East Asian businesses. This points to the need for a more cohesive, rules-based regional economic integration framework to provide fair, stable and predictable rules for trade and investment. Various options for more cohesive, region-wide integration have been put forward, including an APEC FTA (FTAAP), Asian FTA (EAFTA or ASEAN+3), CEPEA and, more recently, TransPac².

¹ In the Phase I report, Cambodia, Laos, Myanmar and Brunei were examined only as part of a composite region due to a lack of country disaggregation in version 6 of the GTAP database. This made it difficult to assess the impacts of CEPEA on these economies. The recent publication of version 7 of the database makes it possible to examine the first three of these countries separately. Brunei is now the only country in the region for which separate country specific data are not available.

² TransPac refers to the FTA between Brunei, Chile, New Zealand and Singapore (previously known as the Trans-Pacific Strategic Economic Partnership Agreement or P4). The US has recently agreed to join TransPac, with negotiations due to commence in early 2009. Australia and Peru have also expressed a strong interest in acceding. As noted in NZMFAT (2008), “one of the objectives of the Trans-Pacific Agreement was to create a trade agreement that could be seen as a model within the Asia-Pacific region and could potentially attract new members. The

This is not to say that regional integration has not already taken place in East Asia: indeed the region is “awash” with various forms of regional economic integration. However, current arrangements may be slowing down and distorting integration of regional production networks (Sally, 2009). Some East Asian bilateral FTAs to date have been somewhat “quick and dirty”. They have significant sectoral exclusions, primarily related to agriculture (ADB, 2002, p182), and some are focused mainly on goods liberalisation, rather than on ‘new economy’ issues such as services and investment, competition policy, government procurement, etc. As a result, a pattern of patchwork ‘hub and spoke’ agreements has been established – there has been a degree of intra-regional competitive liberalisation.

The ‘hub and spoke’ arrangements present some well-known problems for regional integration (Scolly, 2003). Such agreements “tend to reinforce the unequal bargaining strength of the parties, since the “hub” can exploit competition among the “spoke” economies, and use precedents established in PTAs with one “spoke” to strengthen the case for inclusion of similar provisions in agreements with other “spokes”. As a result, spokes tend to seek additional PTAs with each other, and some larger spokes attempt to act as “mini-hubs”. This all adds up to a complex set of overlapping PTA arrangements, which has been described as a “noodle bowl”.³

As noted in Sally (2009, p38) and Petril (2008, p8), this noodle bowl could potentially impose tariffs on products that result from production chains spanning several countries within the regional network of PTAs. This increases the administrative burden facing businesses, and thus reduces efficiency. This in turn threatens to slow down the integration of regional production networks, which is so important to the economic development of the region.

These factors indicate that there is a good case for further examining deeper regional integration in East Asia through a vehicle such as a CEPEA.

3.2 A note on the global economic environment

agreement is open to accession ‘on terms to be agreed among the parties, by any APEC economy or other state’.”. TransPac is a concrete example of open regionalism, as espoused in the CEPEA Phase I Report .

³ In the longer run, as the complexity of overlapping ROO increases in East Asia, and the benefits from regional PTAs reduces (as a result of previous efficiency gains delivered by already-signed agreements), it could be posited that some harmonisation will naturally be induced (Petri, 2008, p.8). While this may be true in theory, such a process could be quickened through implementing a shared coordinating mechanism such as that which might be established under a CEPEA.

The global economic outlook has deteriorated significantly over the past year. In such an environment, there is a grave risk that countries will start to become more inwardly-focused, and concentrate policies on protecting domestic jobs rather than on becoming more integrated with the rest of the world. This can result in trade barriers such as export subsidies and export taxes being unilaterally imposed, rather than being gradually removed over time. Such knee-jerk reactions can lead to retaliatory actions by trading partners who are affected by these trade barriers. As witnessed by the period following the 1930s Great Depression and the introduction of the Smoot-Hawley Tariff Act in the US, these actions can have significant anti-integration ‘signalling’ effects. They also prevent resources being used efficiently at the very time when such allocation is most vital and can impose substantial costs on households and businesses when both are already facing economic hardship.

It is, therefore, essential that the current international economic downturn should act as a spur to regional integration, not a brake on it. As noted by Sally (2009, p15), “an economic crisis...is when a period of ‘extraordinary politics’ can provide a window of opportunity for thoroughgoing reforms (that would not be possible in “normal” political circumstances)”. The experience of Australia and New Zealand in the mid-1980s strongly aligns with this view – trade liberalisation and regulatory reform are both politically much easier to implement and more beneficial during very difficult economic times.

It is particularly essential for economies in the East Asian region to retain an emphasis on reducing existing trade barriers because of the current difficult economic circumstances, and not despite them. As noted by Sally (2009, p28), “labour-abundant countries in East Asia, and in South Asia, have the most promising political economy to support external liberalisation and global integration”. The slow pace of discussions at the multilateral and regional level is not in the economic best interests of the region. Current circumstances require a significant acceleration of the pace of work on a CEPEA as a valuable vehicle for enabling regional integration to meet the challenges of the global economic environment.

We now examine each of the CEPEA pillars outlined in the Phase I report in more detail.

4. Liberalisation

The liberalisation of trade in goods and services and investment flows has long been recognised as important to economic growth and social development. In depth studies by the OECD, World Bank and NBER strongly support that countries with more liberal trade policies have more open economies that grow faster than those with more protectionist policies. Some major developing countries (sometimes referred to as “new-globalisers”) have registered significant increases in their trade to GDP ratios, alongside per capita income increases, poverty reductions and improvements in human welfare measures such as literacy, infant mortality and nutritional intake (Sally, 2009, pp3-4).

In order to inform stakeholders that may be affected by trade liberalisation in East Asia, it is useful to provide estimates of the potential gains from deeper regional integration.

4.1 Modelling

4.1.1 Approach⁴

In this study, we essentially replicate the computable general equilibrium (CGE) modelling exercise conducted in the Stage I report, with one major difference – we use the recently released version 7 of the GTAP database. This database differs from the version 6 used in the Stage I report in a number of ways (see Narayanan and Dimaranan, 2008), but the two most significant improvements are:

- (i) The global economy is portrayed as at 2004 (compared to a 2001 base year in version 6), with trade flows and trade protection data updated accordingly.
- (ii) There are 113 regions in the database (compared to 87 in version 6). Of particular interest for this report is the addition of Cambodia, Laos PDR and Myanmar as separate regions (these countries were part of a composite region in version 6).⁵

We aggregate the database into 22 regions and 16 sectors (see Table 2 in Annex for aggregation details). As was done in the Stage I report, we model a number of scenarios for regional integration using the static GTAP CGE model (see Hertel et al, 1997, for a description of the GTAP model). In addition to removing tariffs, which is a representation of the most basic FTA that could be considered, we also incorporate trade facilitation and technical assistance/cooperation effects. Specifically, and following Ando (2008) and the Stage I report, we assume that trade facilitation would lead to a 10% improvement in the efficiency of importing goods⁶ to countries involved in a CEPEA. We further assume that

⁴ The assistance of Professors Shujiro Urata of Waseda University and Mitsuyo Ando of Keio University on modelling assumptions used in the Stage I report is gratefully acknowledged. We do not discuss the magnitude of the trade facilitation and technical assistance shocks in this paper, although note that this could be examined in more depth in future work.

⁵ Unfortunately Brunei remains in a composite region alongside Timor Leste, so we cannot definitively estimate the impacts of East Asian regional integration on Brunei. However, given the economic size of Brunei compared to Timor Leste (Brunei's economy is around 10 times as large and thus dominates the composite), it is reasonable to expect that the impacts on the composite region in our analysis are largely reflective of the likely impacts in Brunei. Splitting Brunei out from this composite region is an avenue for further research.

⁶ This 10% trade facilitation applies to all East Asia Summit countries, apart from Singapore, which takes a 5% efficiency improvement, reflecting its already efficient customs system. By way of comparison, the second APEC

technical assistance and economic cooperation resulting from regional integration under a CEPEA lead to a 1% productivity improvement in developing countries.⁷

Table 1 Modelling scenarios

Scenario 1	East Asia Summit: Tariff elimination only
Scenario 2	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation
Scenario 3	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation; all agriculture and food products excluded
Scenario 4	ASEAN+3: Tariff elimination only
Scenario 5	ASEAN+3: Tariff elimination plus trade facilitation plus cooperation

Source: Authors' calculations

Trade Facilitation Action Plan aims for a further reduction of trade transaction costs by 5 per cent in the period 2007-2010 (APEC, 2007).

⁷ Developing countries are defined as all ASEAN countries (excluding Singapore), China and India.

4.1.2 Results⁸

The key macroeconomic modelling results are presented in Table 3 and Table 4 in the Annex. They are consistent with those presented in the Stage I report. The most salient points are as follows:

- The welfare gains from a comprehensive CEPEA that incorporates trade facilitation and technical assistance provisions are far greater than those estimated for an agreement that covers tariff liberalisation only.
- All CEPEA countries experience welfare gains and higher economic activity under a comprehensive agreement.
- Developing CEPEA countries gain more, in relative terms, than developed countries from a comprehensive agreement.
- Cambodia, Laos PDR and Myanmar all experience significant welfare and GDP improvements as a result of comprehensive regional integration.
- The gains to almost all ASEAN+3 countries are larger under a CEPEA agreement than they are under an ASEAN+3 agreement.
- In addition to the smaller welfare gains for most ASEAN+3 countries (relative to a CEPEA agreement), an ASEAN+3 agreement would have negative economic implications for Australia, India and New Zealand. GDP drops in these three economies if they were excluded from regional integration in East Asia.
- Excluding agriculture and food products from a CEPEA reduces the potential GDP gains to all members. The welfare gains to agricultural exporters such as New Zealand and Australia are reduced considerably (by 23% and 28% respectively) if agriculture is excluded. The welfare gains to some other countries such as Indonesia, Thailand, Cambodia, India and Vietnam also drop by between 10% and 16%.
- A decomposition of the welfare results (not shown, but available upon request) indicates that the main gains are from own-country liberalisation, rather than through enhanced market access in trading partners. That is, it is the competitive pressures from

⁸ As noted in Kiyota et al (2009) “It is important to understand that CGE modelling simulation results provide indications of the potential economic changes involved. In this respect, they are not meant to be empirical forecasts or predictions of the changes since they are not derived from econometric methods that can yield statistically-based estimations... CGE modelling results are therefore to be interpreted as the potential effects of trade liberalisation at the microeconomic level, holding macroeconomic influences constant”.

liberalisation that deliver efficiency improvements in both developed and developing East Asia Summit countries under a CEPEA.

In summary, the modelling exercise provides evidence, which is consistent with theory and previous empirical work⁹, that the greater the number of countries in an FTA in East Asia, the greater the economic gains to participants. It also shows that more comprehensive agreements, in terms of product coverage and provisions to effect technical assistance and trade facilitation, deliver more substantial gains than agreements with partial liberalisation or a tariff-only focus.

This raises the question of how goods modalities might be designed under a CEPEA. There is a wide range of modalities employed in existing regional agreements, and caution needs to be taken in being too specific or prescriptive and presenting a ‘one-size-fits all’ set of rules, particularly as a CEPEA contains countries of varying levels of development. That said, some general principles can be developed to shape the discussions:

- (i) The agreement must be consistent with the provisions of GATT Article XXIV. It must eliminate duties and other restrictive regulations on “substantially all trade”. While no specific threshold for “substantially all” has ever been widely accepted, consideration should be given to both volume and value aspects of trade in setting thresholds.
- (ii) A CEPEA should remove barriers on a high percentage of tariff lines, and also on lines where trade is heavily concentrated¹⁰ (so as to incorporate sectors which may have been non-traded or traded at a very low level due to trade chilling effects).
- (iii) The precise proportion may vary between PTA members, according to their development levels, but should not deviate significantly from this benchmark.
- (iv) The removal of the vast majority of tariffs should occur upon entry into force.
- (v) Any tariffs that are not eliminated upon entry into force should be phased to zero in a commercially meaningful timeframe, generally accepted as being a period of 10 years.¹¹ This timeframe and phasing sequence should be specified upon signing the PTA.

⁹ E.g. Scollay and Gilbert (2001), Wang and Schuh (2000).

¹⁰ Scollay (2005) suggests that 90% of tariff lines can be considered an absolute minimum, although many PTAs in the Asia Pacific have liberalised a greater proportion of trade.

¹¹ As per the 1994 “Understanding on the Interpretation of Article XXIV” (WTO, 1994).

- (vi) No sector should be excluded from the tariff reductions unless there is a legitimate reason under the GATT for public health, safety, morals, national security, etc purposes.
- (vii) Concerns about sensitive sectors such as agricultural products should be addressed using slower phase-outs and consideration of safeguard mechanisms if necessary, rather than being excluded entirely.

4.2 Services and investment

The modelling work above has focused on merchandise trade liberalisation, primarily because standard CGE models are not generally well set up to consider the impacts of services and investment liberalisation. This in turn is due to the well-known considerable statistical difficulties inherent in measuring the size and nature of services trade flows and the barriers that may inhibit these trade flows. However, given the size of most countries' services sectors (often around 2/3 of GDP), and the rapidly growing nature of cross-border trade in services, it is essential that any CEPEA negotiation take a comprehensive approach to services liberalisation. Services are an important element of regional integration and complement goods and investment liberalisation provisions.¹²

Services trade takes place through a variety of channels or 'modes'. Trade through commercial presence (Mode 3) represents around half of total services trade and cross border supply (Mode 2) around 35%. Consumption abroad (Mode 1) accounts for 10 to 15%, with only a small 1 to 2% being attributable to the presence of natural persons (Mode 4). The prominence of Mode 3 in particular indicates that services "trade" is to a large extent about foreign investment (Fink and Jansen, 2007, p3). As outlined below, many of the services trade barriers are indeed related to investment issues.

4.2.1 Nature and impacts of services trade barriers in East Asia

A wide range of barriers to services trade exist in global markets. Such barriers include (UNCTAD, 1996; Australian Productivity Commission):

- Bans on foreign investment in certain sectors.
- Ownership restrictions (e.g. limit of 25% foreign ownership in a sector).
- Screening and approval (sometimes involving national interest or net economic benefits tests).

¹² This section draws extensively on Ballingall and Stephenson (2005).

- Restrictions on the legal form of the foreign entity.
- Minimum capital requirements.
- Conditions on subsequent investment.
- Conditions on location.
- Admission taxes.
- Compulsory joint ventures with domestic investors.
- Limits on the number of foreign board members.
- Government appointed board members.
- Government approval required for certain decisions.
- Restrictions on foreign shareholders' rights.
- Mandatory transfer of some ownership to locals within a specified time (e.g. 15 years).
- Performance requirements (e.g. export requirements).
- Local content restrictions.
- Restrictions on imports of labour (e.g. visa restrictions), capital and raw materials.
- Operational permits or licences.
- Ceilings on royalties.
- Restrictions on repatriation of capital and profits.

The cumulative effect of these services trade barriers distorts services trade in much the same way as do agricultural and manufacturing barriers in East Asia. They impose costs on firms and consumers, limit international competition, prevent efficiency gains from resource reallocation and allow protected services providers to price at levels that are above where they would be in a fully competitive market. They also prevent important technology transfer possibilities that could allow economies (and particularly developing countries) to become more technologically advanced.

In addition, services barriers not only limit market access to relatively efficient *foreign* providers, they often prevent *domestic* firms entering the market. The result is that domestic services markets can become dominated by potentially inefficient firms which do not need to adjust their rent-seeking behaviour due to competitive pressures.

4.2.2 Benefits of services trade liberalisation in East Asia

Given the negative efficiency effects of services trade barriers as outlined above, the removal of services barriers in CEPEA is desirable for many of the same reasons that goods liberalisation has been rigorously pursued for many decades: to allow East Asian countries to better exploit their comparative and competitive advantages and to reallocate resources in a more efficient manner. In addition, services liberalisation can deliver important welfare gains that result from increased domestic competition. That is, as services barriers are lifted, other domestic firms can enter the domestic market, potentially creating significant efficiency gains.

Developing countries in particular stand to gain relatively more from a managed liberalisation of services trade. For example, reduced barriers to trade in transportation services makes imported intermediate goods cheaper (which is especially important given the high value of intra-East Asia Summit trade) and subsequently final goods exports more competitive. Liberalisation of transport services can also assist developing countries in attracting badly-needed foreign investment and foreign expertise to develop existing infrastructure or create new infrastructure. Thus services liberalisation can help to stimulate investment in infrastructure development where domestic funding may have otherwise been difficult to secure (given public sector budget constraints and limited access to international capital markets) (OECD, 2008b). Indeed, OECD (2008a) suggests that the productivity-enhancing effects of FDI are the strongest (relative to agriculture and manufacturing) when foreign presence is encouraged in services industries.

Tourism is another sector which can benefit from services liberalisation and which is becoming increasingly important to developed and developing countries alike (OECD, 2006b). If services that are closely related to the tourism sector (air transport, telecommunications, internal transport, accommodation, etc) are liberalised, their costs will decrease as efficiency gains are generated. This will make tourism services cheaper and more internationally competitive.

Mode 4 services, whilst presently a small proportion of services trade, has the potential to deliver significant welfare gains if liberalised. One study estimates a US\$150 billion gain from a 3% increase in the temporary movement of natural persons from developing to developed countries (Winters, 2002). The enhanced linkages that Mode 4 services trade can deliver can increase investment flows and skill transfers between countries, which in turn improve a country's wealth and create jobs (Cattaneo and Nielson, 2003).

Services liberalisation is also an important tool for development in that it can confer long run growth benefits. This is because trade in services, particularly imports of services, can enhance physical, social, human, and institutional capital in a fashion that does not necessarily come so obviously from increased goods trade (UNCTAD, 2004). Services liberalisation can help developing countries to better exploit their comparative advantages through technology transfer. For example, many East Asian economies have a large proportion of their resources (land and labour) devoted to agricultural production. However, they are often capital and knowledge-poor. Services liberalisation, particularly through Modes 3 and 4, would allow economies that have strengths and know-how in agricultural techniques (such as Australia and New Zealand) to work with domestic producers to lift domestic agricultural productivity. This will have important economic development implications.

Recent theoretical advances in the trade literature (namely Grossman and Rossi-Hansberg, 2008) have highlighted the growing importance of 'trade in tasks'. This is closely related to offshoring, trade in services and investment flows. In this context, a 'task' refers to a small piece of value added being completed by each factor of production (capital, labour, etc) along the length of a regional production network or supply chain. This production

network can span many countries or regions as technological and communications advances have reduced the costs of moving from one part of the production chain to the next: thus weakening the need for labour specialisation and geographic concentration to be inextricably linked.

This is precisely the nature of East Asian regional production networks – a final good will often have passed through several countries and several production processes before it is sold to the end consumer. Grossman and Rossi-Hansberg (2008) use this framework to demonstrate that if the costs of trading in tasks fall, which could occur via services or investment liberalisation, significant positive productivity effects result.

Therefore it can be suggested that services and investment provisions under an ambitious CEPEA would lead to trade in tasks taking place more efficiently across East Asia: regional production networks would become more profitable, and the returns to labour and capital should increase.

Specific aspects of services and investment negotiations to be considered under a CEPEA include:

- The outcomes of the negotiations must comply with Article V of GATS so that there is substantial sectoral coverage, national treatment-type discrimination is substantially eliminated and barriers are not raised against non-members. ‘Substantial’ should be taken to mean that most sectors, covering the vast majority of trade volumes in all modes, are liberalised.
- Liberalisation should occur in a reasonable period of time, perhaps phased in where necessary within a 10 year period (at maximum).
- Regulations on domestic service sectors do not have to be scrapped, but any discriminatory treatment afforded by these regulations must be removed. General exemptions related to security and balance of payments concerns are permitted and should be made in a transparent fashion.
- A negative list approach to services liberalisation is preferable

While the positive list approach is used in GATS and is therefore familiar to many countries, there are some difficulties associated with it (ADB, 2008, pp64-67). First, discussions progress more slowly than under a negative list approach, as a number of rounds of ‘offer-request’ negotiations are required to move towards agreement. Second, and more importantly, a positive list does not ‘future proof’ liberalisation provisions for new services to be added to the agreement, whereas a negative list assumes that all current and future services are considered free of restrictions unless listed in the ‘non-conforming measures’ Annex. A negative list approach can thus be considered as more transparent and flexible.

5. Cooperation

5.1 Why are cooperation activities important?

While much of the focus of countries negotiating PTAs is on enhancing market access, it should be recognised that there are broader economic and developmental gains to be had from regional integration. As noted by the IMF (2007) “Regional trade integration can serve as a vehicle for dialogue and coordination on regional issues that are not part of the multilateral agenda. These might include regulatory harmonization, infrastructure development, and collaboration among members to facilitate transit trade and transport. And they can stimulate inward foreign direct investment and growth through technological transfers”. It is through these types of ‘dynamic gains’ from trade that trade liberalisation can result in not just one-off lifts in economic activity, but sustained increases in the productivity growth rate (OECD, 2006a).

The modelling exercise in this report has illustrated that the potential economic benefits from technical assistance or cooperation activities under a CEPEA that boost domestic productivity growth are significant. Cooperation activities are thus likely to be vital to the overall success of deeper integration in the East Asian region, where economic development levels are varied (ADB, 2002, p174) and some economies will be better placed to deal with the requirements of deeper regional integration than others. This creates an information gap that can be usefully filled by cooperative activities. The issue is well summarised by Urata (2005) who suggests that “it is important to deepen mutual understanding through closer communications and active exchange of people at all levels, such as exchange programs for high school and college students, politicians, and bureaucrats”. To this list one could also add business owners and managers who will be engaged in trading activities.

5.2 Types of cooperation exercises

Cooperation activities typically incorporated into PTAs as part of the overall package of measures designed to boost trade, services and investment linkages between members – over and above market access provisions – include:

- Capacity-building through inter-governmental seminars and workshops.
- Training, information-sharing and transfer of know-how between businesses and officials in trade-related matters.
- Visits of experts between countries for in-market demonstrations of key aspects of trade liberalisation and facilitation.
- Memoranda of Understanding on issues of mutual importance.

Examples of such cooperation exercise can be seen in many recently concluded PTAs, such as the Australia-New Zealand-ASEAN FTA.

5.3 Areas for cooperation activities

Such cooperation activities commonly cover areas such as:

- Customs and origin matters
- Technical standards
- Trade facilitation (particularly related to small and medium enterprises)
- Intellectual property rights
- Counterfeited goods
- Agricultural technology
- Environmental and labour issues.

These activities are designed to give officials in developing countries in particular a better understanding of the key issues that stem from trade liberalisation.¹³ They will then be able to communicate more effectively with domestic stakeholders and interest groups. Some are discussed in more detail below in section 6 as they tend to overlap with trade facilitation.

5.3.1 Agricultural cooperation

Given the diverse levels of agricultural sophistication amongst East Asia Summit members, the importance of agriculture in some countries' trade profiles, and the significant benefits that can be generated through domestic agricultural reform¹⁴, special mention might be given to agri-tech cooperation covering production, processing and storage technologies. This cooperation can help countries that have land and labour resources in agriculture, but which may be lacking in productivity-enhancing capital or innovative farming and processing techniques.

Encouraging technology transfer in agriculture and creating a better understanding of how agricultural sectors in East Asia can compete on global markets without the need for ongoing and potentially trade-distorting government support can also contribute to longer

¹³ Such cooperation activities need not solely relate to the implementation of a CEPEA. There is likely to be value in investing cooperation resources in improving the technical capacity of actual or potential trade negotiators so that they are able to have more informed and confident discussions at the negotiating table.

¹⁴ See, for example, Sandrey and Reynolds (1990) and Lattimore (2005).

run food security and food safety objectives in the region.¹⁵ As noted above in section 4.2.2, such technology transfer can also be encouraged through the liberalisation of agri-services trade.

5.3.2 Environmental and energy cooperation

Another area of cooperation that is becoming increasingly important in the modern trading system relates to environmental and energy issues. A major global trend in many developed countries is that consumers (and subsequently retailers) are becoming more aware of the environmental and ethical qualities of the goods and services that they purchase. Climate change has become one of the major economic and social issues of the 21st century. Managing and mitigating anthropogenic greenhouse gas emissions have become significant priorities for governments, businesses and individuals around the world. Issues such as ‘buy local’ campaigns, carbon footprints, traceability and fair trade are starting to affect consumer preferences. This presents both challenges and opportunities for producers and exporters, and cooperation activities could usefully consider issues such as:

- (i) How could trade in environmentally-friendly goods and services be liberalised in order for a CEPEA to contribute to improved climate change (as well as trade) outcomes?
- (ii) How can agricultural exporters use technological advances (such as more efficient fertilizer application techniques or feed improvements) to boost production while reducing environmental externalities?
- (iii) How can on-farm producers and primary processors reduce their energy input whilst maintaining production (i.e. enhancing their energy productivity)?

5.3.3 Financial cooperation

Financial cooperation may be another area of cooperation warranted in light of the global crisis. It has been suggested by some that the accumulated reserves of East Asia Summit members could be used to improve region wide soft and hard infrastructure. While this idea has some merits, great care would be needed to ensure that any use of accumulated reserves is approached through an efficiency lens. Funds should not simply be transferred

¹⁵ For an interesting discussion of Japan’s agricultural system, and how reform of the sector could generate economic gains at the same time as contributing to greater food security, see Honma et al, 2009.

between consumers/firms/governments in region. Bids should only be allocated to those projects that have completed robust cost-benefit analyses of strategically important region infrastructure developments.

5.3.4 Small and Medium Enterprises

A key target audience for cooperation activities under a CEPEA is likely to be Small and Medium Enterprises (SMEs). SMEs are vitally important to many East Asian economies but may find it difficult to take full advantage of trade liberalisation opportunities due to the proportionally high set up costs associated with greater internationalisation efforts. Outreach activities that help SMEs to harness the potential benefits that are presented by regional economic integration might include regional ‘roadshows’ and dedicated trade liberalisation and facilitation websites.

5.3.5 Use of analytical tools

As this report has demonstrated, there is considerable value, in terms of informing policymakers and other stakeholders, in using economic modelling techniques to illustrate the potential benefits and adjustments that result from deeper regional integration. There may not be a good understanding of how to use such modelling techniques in all East Asian countries. This may reduce the ability of researchers to answer important economic and political economy questions such as “how will a CEPEA benefit my country?” and “which sectors will gain the most?” There is scope for cooperation activities, possibly training courses and workshops coordinated by ERIA, that focus on improving the economic modelling capacity of interested researchers and policymakers. that could usefully boost the analytical capacity of interested parties.

6. Facilitation of trade and investment

The economic modelling presented in this report clearly highlights the importance of trade facilitation. CEPEA countries need to get at-the-border and behind-the-border policy settings right to maximize gains from co-operation and liberalisation. Facilitation of trade and investment is much wider than trade facilitation at the border. It is defined by APEC as “the simplification and rationalisation of customs and other procedures that hinder, delay or increase the cost of moving goods across borders... so that goods are delivered in the most efficient manner” (APEC, 2007, p1). Trade facilitation in its broader sense covers, *inter alia*, trade facilitation and investment protection, government procurement,

harmonization of rules of origin, mutual recognition agreements, competition policy and intellectual property rights. We touch on these areas briefly below.

It has been estimated that the ‘hidden’ costs of trade equate to as much as 15% of the value of the goods traded in some cases (OECD, 2005). These costs are imposed on businesses through higher than necessary administrative and processing costs (red tape) and on governments through lost revenue resulting from incorrectly identifying the origin of products or through smuggling. These costs are ultimately, and inevitably, passed on to the final consumer.

Therefore measures implemented under a CEPEA to improve trade facilitation could deliver significant welfare gains by reducing the ‘wedge’ between producer and consumer prices. As shown in the modelling section of this report, these gains are possibly as large as those attributable to tariff liberalisation. Scollay and Vigil (2003) agree that “a comprehensive package of trade and facilitation measures can provide benefits to PTA members at least as great as the traditional PTA elements of trade liberalisation”. They add that “member-specific facilitation measures should be applied only where it is not possible to use international standards” (Scollay and Vigil, 2003).

Furthermore, developing countries are likely to gain more, in a relative sense, than developed countries from improved trade facilitation because of the relative inefficiencies in their customs and other procedures. Countries that are dependent on agro-food exports and/or have a high proportion of the business structure being SMEs are likely to make the largest gains, as the costs of poor facilitation systems imposes disproportionately on these parts of the economy (OECD, 2003; OECD, 2005). Undertaking trade facilitation reforms is not cost-free, however, which may explain why some countries display reluctance to commit to investing in these improvements. In addition, there may be a lag between implementing reform (absorbing the cost) and subsequently experiencing improved trade flows and higher government revenue (the benefits). This suggests that there may be a potential role for cooperation activities, as outlined in section 5, under a CEPEA to assist with the adjustment costs.

6.1 Customs facilitation

Simplifying border procedures is the key to trade facilitation. As ‘trade in tasks’ and fragmentation of regional production networks intensifies, the incidence of intermediate goods crossing multiple borders before being moulded into final goods increases. This brings into sharp focus the costs of each economy’s customs processing functions.

Options to streamline border processing functions may include (OECD, 2005; APEC, 2007):

- Allowing traders to file the documentation for shipment before it arrives at the border, preferably using an online system.
- Introducing electronic systems for paying duties.
- Developing border risk identification assessment processes so that low-risk shipments are paid minimal attention and processed rapidly, with the freed up resources redirected towards higher risk shipments.
- Ensuring that the various domestic agencies that may need to be involved in processing and inspecting goods (customs, police, agriculture ministry, etc) do so in a coordinated and efficient way so as to avoid double handling shipments.

Given the diverse levels of customs procedures efficiency within East Asia Summit countries, there would seem to be a logical case for cooperative activities that allow for the transfer of know-how in this area. This could build on, for example, the ‘single window’ project that is already operating in ASEAN countries.¹⁶

6.2 Government Procurement

We have so far focused on trade in goods and services carried out by private firms and individuals. It should be noted, however, that central and local authorities account for a large proportion of economic activity in most economies and are a major demander (and supplier) of goods and services. In East Asia, government procurement typically accounts for around 15-20% of GDP in developed countries, and 8-12% in developing countries (OECD, 2002). It follows that there are large gains to be made from ensuring that government purchases of goods and services in East Asia are directed as efficiently as possible.

As with private expenditure, government procurement can benefit from increased competition, including from foreign providers. The openness of government procurement sectors varies widely in East Asia.¹⁷ It is important to recognise the unique nature of some aspects of government procurement that may preclude it from being fully opened up to competition and the sovereign rights of governments to design domestic regulations accordingly. That said, encompassing government procurement under a CEPEA is not about exposing domestic suppliers unfairly or ‘selling off the family silver’. Rather, it is about ensuring that such regulations do not – as much as is practicable – unduly discriminate against foreign providers.

¹⁶ See <http://www.aseansec.org/18005.htm>

¹⁷ Of the 53 countries covered, the IMD Competitiveness Yearbook (2006) ranks Australia, New Zealand and Singapore as having the most open government procurement regimes amongst the countries covered by the East Asia Summit. Some larger East Asian economies such as Korea, China and Japan are considered to be less open to foreign competition. South-East Asian economies such as Thailand, India and Malaysia are generally ranked somewhere in the middle of these two groups.

Government procurement provisions are often viewed through a defensive negotiating lens – negotiators are often concerned with protecting domestic (and possibly inefficient) participants in supply chains. It is important to balance this view by considering:

- (i) The potential benefits that could accrue to domestic suppliers who *are* internationally competitive from greater entrance opportunities in overseas government procurement markets.
- (ii) The potential productivity gains to domestic providers: Opening up some parts of government procurement supply chains to international competition will make inputs into these sectors cheaper and/or of superior quality so that more output can be delivered for the same cost. These productivity gains will lead to improved development and social outcomes.

6.3 Standards

Another important area of trade facilitation relates to the harmonisation of standards between countries. Specific standards of interest are Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) measures. While such measures are permitted under the WTO for reasons of food safety or protecting human, animal or plant health, they must be based on sound science and must not arbitrarily or unjustifiably discriminate against countries where similar conditions prevail.

When considering how standards might be harmonised and streamlined under a CEPEA in order for trade to flow more freely, whilst maintaining appropriate safety levels, some basic principles of efficient regulation are worth considering (Kleitz, 2002; ADB, 2002):

- The development and administration of standards by decision-makers should occur in a transparent fashion. Domestic and foreign businesses and relevant authorities should be aware of the potential costs and benefits of any changes to TBT, SPS and other standards. These changes should be signalled well in advance and not adjusted often, so that businesses can operate in a stable and predictable regulatory environment.
- Imposed standards should encourage non-discrimination among market participants so that any unnecessary trade restrictiveness is avoided.
- Wherever possible, international standards or recognition of equivalency should be employed as a basis for domestic regulations. This will reduce the information costs of new regulations for businesses.

In short, a CEPEA measures on standards should seek to be trade-facilitating and efficiency-generating rather than protectionist in nature.

6.4 Rules of Origin

All trade agreements require the design and implementation of rules of origin (ROO). These rules ensure that preferences are given only to those countries which are members of the PTA and to the extent intended. However, as Scollay (2003) notes, they also serve other purposes besides assuring the ‘integrity’ of the agreement. Depending on how they are designed and implemented, they can facilitate trade at one end of the scale, or serve to chill trade by being protectionist in nature at the other end of the scale.

As such, ROO are not always used as a “neutral instrument of preferential trade”. ROO can be driven by the same political economy factors as tariff protection (Estevadeoral and Suominen [ES], 2003, p.3). Indeed it is possible for ROO to be used as devices to pacify sectors that are particularly vocal or influential in their protectionist lobbying efforts. Poorly designed ROO can result in economic inefficiencies (as with any other trade barrier) and can make market access outcomes less effective (Cadot et al, 2006, pp10-15).

In general, when considering whether products that are not ‘wholly obtained’ from within a PTA are ‘substantially transformed’ and thus eligible for preferential tariff rates, three possible types of ROO are employed:

- (i) Change of Tariff Classification (CTC) – this approach requires that there is a change in classification at the HS2 (chapter), HS4 (heading), HS6 (sub-heading) or HS8-10 (item) digit level between the inputs from non-PTA countries and the manufactured good.
- (ii) Regional Value Content (RVC) – this approach requires that a product must acquire a certain minimum local value in the exporting country.
- (iii) Technical/Process requirements – this approach requires goods to have undergone certain manufacturing operations within the originating country.

Many PTAs in the East Asian region use combinations of these approaches, which probably reflects the lack of a commonly accepted ‘best practice’ way of implementing ROO under PTAs. Countries have also tended to change their approach over time. Furthermore, the empirical evidence on the restrictiveness or otherwise of these different approaches remains very limited.

It is therefore difficult to provide a simple answer to the question: Should ROO be liberal or strict? As noted in BERR (undated, p3) “Too strict a ROO will mean that the exporters in the recipient country cannot comply with the ROO or can only do so at prohibitive cost and therefore loses the benefit of the preference. Too liberal a ROO and the benefit of the preference accrues to some third party. The optimal ROO strikes a balance between the costs imposed on the recipient on the one hand and providing incentives to add value in the recipient on the other. But the optimal ROO will vary according to the specific product and country in question”.

This point is borne out by the wide range of approaches to ROO witnessed in current East Asian PTAs. The complexity of ROO under East Asian PTAs ranges from very high (especially in some of Japan and Korea’s earlier PTAs) to relatively low (the China-ASEAN PTA, for example). Complying with ROO can present challenges for businesses – the ROO provisions of PTAs often run into hundreds of pages. At a firm level, the costs of complying with rules of origin have been estimated at between 3 and 5% of the free on board value of the exported goods. As many businesses trade across a large number of borders, these costs are likely to escalate. This hits small to medium exporters particularly hard as they may be less able to pass these additional costs on to the final consumer (Scollay, 2003).

For multinational companies engaged in regional production networks, aside from the administrative cost, the major concern is that complex ROO can reduce their ability to allocate resources efficiently among operations that are located in different geographic locations inside and outside of the PTA (Petri, 2008, p8). In contrast, well-designed and flexible ROO can attract efficiency-seeking foreign direct investment from firms engaged in such networks (APEC, 2008)

It is therefore essential that a CEPEA incorporates a ROO framework that complements and reflects:

- (i) The tariff liberalisation agreed to under the agreement.
- (ii) The highly inter-dependent nature of intra-Asian trade flows.
- (iii) The rapidly-changing nature of the global economy and the way in which goods and services are traded in regional production networks.

With these three factors in mind, some possible guidelines for ROO negotiations under a CEPEA include:

- The ROO should first and foremost prevent unwanted trade deflection involving non-members and should be sufficiently liberal that they actively facilitate trade amongst members.
- The ROO should be transparent and predictable for both businesses and the officials implementing the regime. In this respect, RVC can be problematic as there is no

commonly accepted way of valuing products, and national authorities can have too much scope to arbitrarily apply valuation rules (ADB, 2002).

- The ROO should be flexible and responsive to changes in economic structure/production techniques. Cumulation rules¹⁸ should facilitate participation in regional production networks and avoid compounding tariffs due to trade in tasks.
- As far as is practicable, ROO should be consistent across countries and products, and with a longer term view towards harmonisation with the ROO of other PTAs.

6.5 Intellectual Property and Competition Policy

An increasingly important aspect of modern, comprehensive PTAs relates to ensuring that domestic regulations on competition policy (CP) and intellectual property (IP) reinforce rather than retard the flows of benefits that stem from goods and services trade liberalisation. This is because it is broadly agreed that open, competitive markets are better placed to deliver the positive welfare gains from trade liberalisation.

It would be fair to say that there has been to date some nervousness amongst some East Asian countries about making firm or deep commitments on CP and IP in their PTAs. This may in part reflect the view that new or more sophisticated regulatory frameworks are sometimes required in order to ensure that liberalisation delivers the expected benefits (OECD, 2008b, p3). However, the degree of commitment required on these two issues is something that should be discussed in preparations for a CEPEA negotiation. As with government procurement (see section 6.2), there is no suggestion here that provisions under a CEPEA should undermine the right of members to implement sensible and equitable domestic regulations on competition and IP. However, processes (dialogue between national experts, information-sharing and cooperation at the very minimum) should be put in place under a CEPEA to work towards building understanding of members' policy settings and how they might impact upon other members. The crucial point here is that it is important to seek to ensure that the benefits of trade liberalisation in East Asia are not undermined by anticompetitive practices.

7. Institutions

¹⁸ Cumulation refers to the degree to which inputs wholly or partly originating from one preferential trading partner are allowed to count towards satisfying a ROO governing processes carried out in another preferential partner.

As well as the specific provisions that would need to be included in the text of a CEPEA agreement, thought also needs to be given to the institutional arrangements that would underpin the liberalisation, facilitation and cooperation activities. Several regional institutions, all with differing but equally important roles, could be considered, as discussed briefly below.

7.1 Domestic institutions

7.1.1 Inter-agency dialogue

If deeper economic integration under a CEPEA is to be successful, it requires more effective inter-agency collaboration and improved institutions in each member country. This is because, as outlined above, trade policy is no longer solely about at-the-border barriers to trade. Many of the issues considered in PTAs and multilateral negotiations are ‘trade-related’ regulatory matters that extend deep into the domestic economy. Getting the policy settings right therefore requires input from a broad range of domestic agencies, not just commerce and industry departments. These agencies should have a common view on the objectives of the PTA in question and take a coordinated approach to the processes involved in negotiating the agreement. A failure to achieve this common view can be damaging to the overall level of ambition (and hence expected economic benefits) of PTAs (Sally, 2009).

7.1.2 Communication with stakeholders

As trade policy decisions have the potential to have significant impacts on businesses, households and other organisations, many countries have developed strong stakeholder communication processes. The objective of such processes is to inform the public of trade policy developments so that there are no ‘nasty surprises’ once the agreement is concluded. This is important for political economy reasons and helps to engage stakeholders in the economic integration process as it develops.

Sally (2009, p42) summarises this well: “Public discussion of policy choices is usually uninformed and misguided...what is lacking is what Patrick Messerlin calls a ‘culture of evaluation’... Independent think tanks and even government bodies should do much more detailed research and analysis on the costs and benefits of trade policies in different sectors of the economy, and then disseminate findings to the public. This would facilitate more informed, intelligent public discussion of policy choices.” Organisations such as ERIA could greatly assist by doing more studies of trade agreements and engaging in greater outreach to stakeholders through workshops, seminars, website publications and capacity-building activities.

For governments, communication processes often start with invitations for the public to submit their views on PTAs that are about to be negotiated¹⁹. Once negotiations begin, ongoing discussions with stakeholders can ensure that priority negotiating areas are addressed. Regular updates on the progress of negotiations should be widely circulated, although the precise details may not be suitable for dissemination due to negotiating sensitivities. This contributes to trade policy transparency and building a domestic consensus around trade liberalisation. Finally, once an agreement has been concluded and signed, it is important to help businesses understand how the PTA might affect their operations, and indicate where they should turn to for further advice. An increasingly-used media for such communication is through dedicated PTA websites – effectively ‘one-stop shops’ for interested parties.²⁰

7.2 Existing regional institutions

As noted above in section 3.1, there is already a high level of regional economic integration activity in East Asia. A CEPEA could usefully draw on – without duplicating the efforts of – some of the regional institutions already in place to help achieve its objectives.

At a political leadership level, the East Asia Summit provides an excellent opportunity for regular meetings of key Ministerial level representatives. This allows progress to be reported and any emerging issues and difficulties to be quickly addressed so that officials can receive clear guidance.

A coordinated cross-country research body will be a valuable source of analytical research into the potential for a CEPEA. Such a body already exists in the shape of the Economic Research Institute for ASEAN and East Asia (ERIA). As well as analysing the potential impacts of a CEPEA and communicating effectively with public and private sector interested parties, this body could also assist with trade policy capacity building to address any competency/capacity of concerns of negotiators and researchers.

A CEPEA would also require some form of regional funding body to assist with resourcing the negotiations proper. The ADB could be a suitable agency for such a task.

¹⁹ See, for example, <http://www.beehive.govt.nz/release/submissions+called+possible+fta+korea> regarding the proposed New Zealand-Korea agreement or http://www.dfat.gov.au/media/releases/department/d019_04.html regarding the Australia-NZ-ASEAN agreement.

²⁰ See, for example, <http://www.chinafta.govt.nz/> for information on the New Zealand-China Free Trade Agreement and <http://www.dfat.gov.au/trade/ftas.html> for an overview of Australia’s current and potential Agreements.

7.3 A CEPEA Secretariat

In addition to drawing on existing institutions, a CEPEA would require the creation of a new body, akin to a Secretariat, that would be responsible for coordinating the negotiations process, storing official documents, monitoring progress on implementation and reporting problems to leaders.

Such an institution may also need to be responsible for housing a Disputes Settlement Mechanism (DSM). DSMs are critical to ensuring that the economic benefits from trade, services and liberalisation under a CEPEA that are outlined above are 'locked in'. While DSMs vary between existing PTAs in terms of detail (see ADB, 2002, pp94-96) they generally take an approach based on the WTO process:

- When potential disputes are raised between members, state to state consultations between parties (possibly facilitated by a CEPEA Secretariat) are the first avenue to take towards resolution.
- If these consultations are not successful, the appointment of an arbitration panel or tribunal may be required.
- Based on the tribunal's rulings, continued non-compliance or non-conformity with the provisions of the PTA may result in the removal or adjustment of concessions.

ADB (2002, pp96-97) suggest that the following best practice principles should be applied to developing a DSM under PTAs:

- (i) The DSM provisions should be consistent with, and if possible, build on WTO obligations. Consideration should be given to which regime has the ultimate jurisdiction if both WTO and PTA rules apply.
- (ii) Formal (and often costly) dispute settlement proceedings can often be avoided through a systematic process of informal and formal bilateral consultations when trade irritants arise.
- (iii) Technical assistance for developing countries may be required to ensure that these countries are able to participate effectively in disputes settlement processes.

The physical location of a CEPEA Secretariat should be such that it is easily accessible to all members (to the extent possible under such a large and geographically dispersed membership) and it should operate under standard principles of good governance and transparency so that all members share ownership of its operations and outputs.

8. Conclusions and suggestions for further research

8.1 Conclusions

Given the intra-East Asia liberalisation witnessed to date, and the potential costs of the region continuing to go down the “hub and spoke” route outlined in section 3.1, this study concludes that there is a clear case for the introduction of a more coordinated approach to regional economic integration through a CEPEA that:

- (i) Improves the efficiency of resource allocation within the region to the benefit of firms and households via hence improved profitability and higher per capita incomes.
- (ii) Enhances rather than hinders the development of regional production networks.
- (iii) Provides for deeper regional engagement than a simple tariffs-only agreement through facilitation and technical assistance activities.
- (iv) Does not act as a ‘stumbling block’ to future multilateral liberalisation.

Such integration must be based on economic principles, rather than on political foundations. A CEPEA must avoid becoming “trade-light” or “PTA-lite” due to not being driven by economics. In the present economic environment, there is ample justification for taking bold steps to progress regional integration: the very last thing countries should be doing right now is becoming more inward-looking. Most firms and households in East Asia will recognise this fact, despite the traditional pockets of resistance. This should provide considerable impetus to political leaders’ efforts to implement a CEPEA.

In considering the optimal design for a CEPEA, based on the three pillars identified in the Phase I report (liberalisation, facilitation and cooperation) as well as institutions, our report has suggested some key principles. These principles have been developed based on the international literature on PTAs, commonly-accepted best practice guidelines from international agencies and economic modelling. The key implications from our analysis include:

- A comprehensive, high quality and ambitious CEPEA should be approached as a ‘single undertaking’. It is not sufficient to solely consider goods liberalisation. A CEPEA must also include substantial services and investment liberalisation so that East Asian countries can better exploit their comparative and competitive advantages and to reallocate resources in a more efficient manner.
- A CEPEA will deliver the greatest benefits when it covers a larger number of countries and does not exclude any sectors from liberalisation. Levels of ambition under a CEPEA should therefore remain high.

- A CEPEA should contain provisions on government procurement, competition policy and intellectual property. Such provisions help to lock in the benefits of trade liberalisation. While these are sometimes contentious issues, and their exact form can be debated, they should remain 'on the table' for negotiators to discuss.
- The differing development levels of potential CEPEA members must be acknowledged. However, given that a large proportion of the benefits from trade liberalisation are generated by domestic reallocation of resources and regulatory reform, deeper economic integration provides the best opportunity for closing existing development gaps within East Asia.
- The gains from a comprehensive CEPEA that incorporates trade facilitation and technical assistance provisions are estimated to be far greater than those estimated for an agreement that covers tariff liberalisation only. Therefore trade facilitation and cooperation must be considered in addition to (not in lieu of) trade liberalisation.
- Cooperation activities under a CEPEA should involve knowledge transfer and information sharing on issues of mutual interest amongst members. Important areas of cooperation could include agricultural technology, environmental and energy issues, financial cooperation and assisting small and medium enterprises. Cooperation could also include training on using analytical tools such as computable general equilibrium modelling to assess and disseminate the benefits and adjustments costs of a CEPEA. All cooperation activities should be centred on improving resource allocation to enhance the ability of members to harness the potential economic and development benefits arising from deeper regional economic integration.
- A key focus of CEPEA trade facilitation activities should be simplifying border procedures. This will reduce the transaction costs of trading activities, which will improve economic outcomes for businesses and consumers alike through improved profitability and lower prices respectively. Of particular importance are customs procedures and the way in which standards (TBT and SPS) are applied.
- The nature of ROO under a CEPEA negotiation will be crucial to ensuring that intra-CEPEA trade flows are boosted after liberalisation. ROO should ensure that trade deflection is minimised and that intra-CEPEA trade is facilitated. ROO must not be used as a form of protection in disguise, or the gains from integration could be undermined.
- When combined, liberalisation, facilitation and cooperation/assistance spur enhanced and more efficient regional production networks and encourage dynamic gains and technology transfer that can deliver improved productivity growth rates. These three pillars can also generate higher levels of investment that are important for developing infrastructure.

- Existing regional institutions such as the East Asia Summit, the ADB and ERIA provide a sound foundation for driving, coordinating, implementing and monitoring progress under CEPEA. An additional institution of modest size may be required in the form of a CEPEA Secretariat to monitor progress and co-ordinate efforts.

8.2 Options for further research

This report has aimed to provide some insights into the potential benefits of a comprehensive, high quality CEPEA. However, it is clear that further research is warranted in a number of areas, such as:

- An investigation into the nature and severity of barriers to services trade and investment flows in East Asia, and the potential benefits from removing/reducing them. This work is already underway through ERIA.
- Additional work on identifying and measuring the ‘dynamic gains’ from trade that could be generated by deeper economic integration in East Asia.
- Further empirical work on the channels through which trade facilitation and cooperation activities can enhance regional economic growth under a CEPEA.
- Case studies of sectors that have benefited from existing PTAs in East Asia. This work is also already underway through ERIA.
- The optimal design of ROO. This work is also already underway through ERIA.
- Options for designing and funding the institutional arrangements required to coordinate, implement and monitor a CEPEA.

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Appendix A GTAP aggregation

Table 2 Regional and commodity aggregation

Regions	Commodities
1 Japan	1 Agriculture and food Paddy rice; wheat; cereal grains; vegetables, fruits and nuts; oil seeds; sugar cane, sugar beet; plant-based fibres; crops nec; Bovine meat products; meat products nec, Bovine cattle, sheep and goats, horses; animal products not elsewhere classified (nec), raw milk; wool and silk-worm cocoons; Meat products; Dairy products; Other food products; Miscellaneous food products; Vegetable oils and fats; processed rice; sugar; beverages and tobacco products
2 China	2 Fishing and Forestry
3 Korea	3 Mining and Extraction Coal; oil; gas; minerals nec
4 Indonesia	4 Textiles, Clothing, Footwear Textiles; wearing apparel; leather products
5 Malaysia	5 Wood & paper Wood products; paper products
6 Philippines	6 Mineral products Petroleum, coal products; chemical, plastic and rubber products; mineral products nec;
7 Singapore	7 Iron and steel
8 Thailand	8 General machinery/metal products Metals nec; metal products
9 VietNam	9 Electronic Machinery
10 Cambodia	1 Transport equipment 0 Motor vehicles and parts; transport equipment nec; machinery and equipment nec
11 Myanmar	1 Other manufacturing
12 Laos PDR	1 Utilities and Construction 2 Electricity; gas manufacture and distribution; water; construction
13 Brunei and East Timor	1 3 Retail and wholesale trade
14 Australia	1 Transport and Communication 4 Transport nec; water transport; air transport; communication
15 New Zealand	1 5 Public Services
16 India	1 Other services 6 Financial services nec; insurance; business services nec; recreation and other services; dwellings
17 Hong Kong	
18 Taiwan	
19 NAFTA	

US, Canada, Mexico

20 EU25

Austria, Belgium, Cyprus, Czech Republic,
Denmark, Estonia, Finland, France, Germany,
Greece, Hungary, Ireland, Italy, Latvia, Lithuania,
Luxembourg, Malta, Netherlands, Poland, Portugal,
Slovakia, Slovenia, Spain, Sweden, United Kingdom

21 Latin America

Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador,
Paraguay, Peru, Uruguay, Venezuela, Rest of South
America, Costa Rica, Guatemala, Nicaragua,
Panama, Rest of Central America

22 Rest of World

All other regions

Source: GTAP v7 database, Narayanan and Walmsley (2008)

Appendix B Modelling results

Table 3 Impacts on GDP

% change in GDP quantity index

Regions	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Japan	0.04	0.64	0.56	0.02	0.63
China	-0.03	4.65	4.64	-0.05	4.49
Korea	0.38	2.67	2.28	0.34	2.64
Indonesia	0.13	4.35	4.13	0.11	4.15
Malaysia	0.62	9.53	8.95	0.57	9.24
Philippines	0.12	5.95	5.51	0.11	5.77
Singapore	-0.02	3.83	3.65	-0.02	3.63
Thailand	0.59	7.46	7.17	0.56	7.21
VietNam	1.61	11.04	10.17	1.60	10.79
Cambodia	0.38	8.59	7.17	0.29	8.38
Myanmar	0.07	6.15	5.36	0.07	6.00
Laos PDR	0.40	5.99	4.69	0.40	5.94
Brunei and East Timor	1.86	6.98	6.14	1.86	6.92
Australia	0.11	1.27	1.20	-0.03	-0.03
New Zealand	0.08	1.94	1.77	-0.04	-0.02
India	0.45	3.40	2.70	-0.03	-0.07
Hong Kong	0.00	0.02	0.02	0.00	0.02
Taiwan	-0.10	-0.18	-0.15	-0.11	-0.17
NAFTA	0.00	-0.02	-0.02	0.00	-0.02
EU25	-0.03	-0.09	-0.09	-0.02	-0.08
Latin America	-0.02	-0.05	-0.05	-0.02	-0.04
Rest of World	-0.03	-0.08	-0.09	-0.03	-0.07

Source: Authors' calculations

Scenario 1	East Asia Summit: Tariff elimination only
Scenario 2	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation
Scenario 3	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation; all agriculture and food products excluded
Scenario 4	ASEAN+3: Tariff elimination only
Scenario 5	ASEAN+3: Tariff elimination plus trade facilitation plus cooperation

Table 4 Impacts on welfareEquivalent Variation²¹, % of GDP

Regions	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Japan	0.18	0.92	0.92	0.17	0.92
China	-0.03	4.37	4.30	-0.05	4.22
Korea	0.68	3.27	3.02	0.64	3.23
Indonesia	0.68	5.13	4.57	0.17	4.51
Malaysia	2.08	13.23	12.45	1.51	12.35
Philippines	-0.06	6.18	5.80	0.01	6.08
Singapore	0.97	7.40	6.82	0.86	6.86
Thailand	2.35	10.01	9.08	2.43	9.84
VietNam	1.99	11.30	9.74	2.14	11.18
Cambodia	-0.06	7.08	6.02	-0.05	7.04
Myanmar	-0.47	6.01	5.48	-0.59	5.55
Laos PDR	-0.92	4.69	4.60	-0.84	4.72
Brunei and East Timor	5.74	13.35	12.68	5.55	12.84
Australia	0.84	2.49	1.87	-0.17	0.06
New Zealand	0.24	2.61	2.05	-0.21	-0.02
India	-0.19	2.77	2.44	-0.10	-0.09
Hong Kong	-0.48	-0.83	-0.76	-0.42	-0.72
Taiwan	-0.92	-2.52	-2.45	-0.85	-2.39
NAFTA	-0.05	-0.15	-0.13	-0.04	-0.12
EU25	-0.07	-0.18	-0.18	-0.06	-0.15
Latin America	-0.07	-0.19	-0.14	-0.05	-0.15
Rest of World	-0.10	-0.46	-0.47	-0.07	-0.36

Source: Authors' calculations

Scenario 1	East Asia Summit: Tariff elimination only
Scenario 2	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation
Scenario 3	East Asia Summit: Tariff elimination plus trade facilitation plus cooperation; all agriculture and food products excluded
Scenario 4	ASEAN+3: Tariff elimination only
Scenario 5	ASEAN+3: Tariff elimination plus trade facilitation plus cooperation

²¹ The equivalent variation is a measure of the amount of income that would have to be given or taken away from an economy before a change in policy in order to leave the economy as well off as it would be after the policy change has taken place. If the equivalent variation is positive, it is indicative of an improvement in economic welfare resulting from the policy change.

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1. Introduction

The vision for CEPEA is deeper and wider integration among countries in the region over time characterized by shared and inclusive growth. In this context, there are two basic questions that need to be answered. How can the adjustments be managed? How can the benefits be maximized?

The approach of Study Phase II should address these issues. There has been substantial work in Phase I that provides background, overview and issues. The next phase should take a more focused approach – one that looks at crucial horizontal concerns, and at the same time, specific key areas as well.

With regards to the former, the need for capacity building is often repeated as essential. Among the areas noted, in this respect, is ICT (more specifically, for example, in the area of e-commerce, customs) and human resource development. Another important concern is the formulation of an enabling ROO regime. Other areas would include- tourism, energy and the environment, food security.

However, at this juncture the Track Two team must take cognizance of both the short-term and medium-term impact and implication of the current global and economic crisis. The immediate issue is to deal with the emerging threats of protectionism. Thereafter experts have to determine whether consciously recommending and implementing measures to accelerate intra-regional trade and investment is a valid course of action.

2. Threats of protectionism

The global recession fuels the rise of protectionism and can intensify as the crisis deepens. The shift to domestic consumption due to planned fiscal stimulus packages worldwide is adding to this threat. Protectionism may be manifested in many ways but broadly, there are 3 channels: (i) through trade in goods and services via trade restrictions; (ii) through FDIs via restrictions on capital flows; and (iii) through restrictions in labor migration.

In trade in goods, countries could resort to the use of non-tariff measures and the policy space created between the average tariffs and the bound rates, with very clear leverage in agricultural products. Another avenue is the use of the trade-environment nexus or the use of environmental standards as technical barriers to trade. This new barrier is more relevant now and will be more binding in the future as the world is moving toward greener technology. The most vulnerable here are developing countries without access to newer and cleaner technology.

In Asian economies, currency intervention was necessary given the extreme volatility in the foreign exchange markets but there appears to be no move to restrict capital account outflows or to revert back to fixed exchange rate regimes. Asian countries remember the lessons learned a decade ago—that in situations of exchange rate volatility, greater exchange rate flexibility is necessary to avoid prolonged and unsustainable currency intervention that would lead to lower levels of international reserves and high opportunity costs.

While the retreat to protectionism is real, it is not an option. Many countries have openly declared not to raise trade barriers. One such declaration was made in the Trilateral Summit (PRC, Japan and Korea) in December 2008; the three countries jointly declared their fight against protectionism and strove to move forward the WTO negotiations.

3. Possible Policy Responses

The region should continue to work for progress in the multilateral trading system as the first best defense against the possible rise in protectionism. Ensuring a return to the Doha Development Round can be a good start. There is room for lowering the wide margins between MFN tariffs and bound rates for agricultural products in Asia and increasing the binding coverage for all goods. The improvement in these policy parameters will introduce more transparency certainly into Asia's tariff regime. Largely forgotten as the first best policy is not multilateral liberalization but unilateral. While this is an unattractive policy at present, one clear policy response in Asia is to continue with its regional liberalization which has been largely consistent with multilateral liberalization.

While exports remains as a major source of growth, there is an increasing sense of urgency to re-examine Asia's export-led strategy. A shift to domestic-led growth will be good in the medium term in order for the region to move toward more balanced growth. However, many economies are constrained by their small domestic markets, fragile fiscal positions and therefore limited degrees of freedom to pursue expansionary policy that can easily translate to inflationary pressures in an environment of depreciating currencies. Given the constraints of a domestic-led growth, the region should diversify its export destinations and/or diversify its export product mix. Asia has not tapped the new emerging markets of Brazil and Chile, as Asia's trade with Latin America is only 2.5 percent.

Services trade in Asia has been growing faster than the world's and hence is a source for growth in trade. Within the region, there is complementarity in services trade due to the region's diverse level of skills. The latter can provide more room to engage in an expansion and/or an acceleration of services trade liberalization without raising trade friction. The 3 huge markets of PRC, Japan, and India have large roles to play, that is, to further expand market access given that the mechanisms are already in place via the ASEAN + 1 FTAs and the bilateral FTAs. The region is well positioned to do this as most FTAs contain services chapters that have gone beyond their WTO commitments.

As services trade is also linked to investment, Asia should continue to keep investment regimes open and liberal but regulate more prudently the short-term portfolio inflows. With these measures, Asia can continue to drive its trade and investment linkages as a source of further and future integration.

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What is the future of the CEPEA initiative?

1. Introduction

Following from the East Asia Summit in December 2008, it was decided that the CEPEA Track II Study Group launch a Phase II study detailing the 3 pillars of: cooperation, facilitation, and liberalization. Meanwhile CEPEA Study Group is aware of the effort made by the EAFTA Study Group that has advocated the establishment of the ASEAN +3 (China, Japan & S Korea) Free Trade Area.

In the first Phase of the CEPEA Study, the Study Group have agreed on three main objectives of CEPEA. It must contribute to deepening economic integration in the region, and at the same time it must help narrow development gaps in the region. Along with these two objectives, sustainable development, which will enable the region to enjoy the benefits of development in the years to come, is reckoned to be the third objective.

To achieve the above objectives of CEPEA, the Study Group recognizes the scope of CEPEA as: economic cooperation, facilitation of trade and investment, and liberalization of trade and investment. Lacking any of the three pillars would seriously impede achievement of the three objectives. The Group also set three basic principles to be followed under CEPEA. Firstly, ASEAN should be regarded as the driving force of economic integration. Secondly, CEPEA should be business-oriented as the business sector will be both the beneficiary and the implementation body of measures under CEPEA. Finally, open regionalism also should be taken into account, as development of the region under CEPEA should contribute to global liberalization, be beneficial to the region outside East Asia, and not hinder the development of the world economy.

2. Regional trade liberalization can be helpful to Global trade liberalization

As noted by Peter Petri (2008)¹, aggressive multi-track strategy – parallel regional, trans-Pacific, and global initiatives may have promulgated a situation whereby the proliferation of many bi-

¹ Petri, A. Peter (2008) 'Multitrack Integration in East Asian Trade: Noodle Bowl or Matrix?', East West Center, *Papers in the Asia Pacific Issues*, paper no. 86.

lateral and mini-lateral FTA negotiations has created a new global framework for deeper economic integration. It is a development that is favourable to multilateralism than thought otherwise.

A particular concern about regional arrangements is the proliferation of inconsistent and confusing 'rules of origin' - famously described as a 'spaghetti bowl' by trade economist Bhagwati in 1995, which will carve up, rather than integrate, world markets, leading to disintegration of the global trading system. Though this concern is valid but could be exaggerated. Indeed, some will argue that regional agreements generate pressure for beneficial deals which countries that are left out of FTAs, and increase the political weight of pro-trade interests within FTAs by making each bloc's economic structure more competitive. In depth analysis of global trade liberalization since 1934 by Baldwin (2006)², had led him to see 'spaghetti bowls as building blocs on the path to free trade'. Furthermore, the accumulation of FTAs erodes the value of 'exclusivity' in bilateral or plurilateral agreements, and thus makes it harder to justify the rising cost of maintaining multiple agreements as compared to a few consolidated regional or global ones.

Asian trade arrangements can be more constructively seen in terms of a trade agreements matrix, in which multiple negotiations produce an orderly progression of agreements to liberalize all potential bilateral relationships and move the region toward a coherent system of freer trade. This 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 (Kawai, 2007)³. It will be an ideal goal to have regional agreements (FTAs and CEPs) coalesced and developed into an Asia wide Economic Community.

3. Asia Economic Community

CEPEA can be considered as an important nascent effort by a group of Asian economies, towards the grand vision of an Asian-wide economic community. We hope all other Asian countries will join the group in the future.

To move towards that goal, concerted efforts have to be made by Asian governments to continuously restructure their economies and making reform that will embrace global competition as well as cooperation. Cooperation and the building of appropriate institutions that are pro-market and able to resolve conflicts and disputes arising from cross border transactions are essential.

² Baldwin, Richard E (2006) 'Multilateralizing regionalism: Spaghetti bowls as building blocs on the path to global free trade', *World Economy*, vol 29, pg. 1451-1518.

³ Kawai M. and Wignaraja G.(2007) "ASEAN+3 or ASEAN+6: Which Way Forward?" *ADB Institute*. Discussion Paper No:

Awareness of the opportunities created by trade liberalization is something we cannot take for granted. Enterprises in each country need to be reminded that FTAs and other regional forum can play a great part in shaping the regional agenda for participation and research.

4. Future of CEPEA⁴

The eventual goal may be that CEPEA evolve into a free trade area or more ambitiously into an economic community. While that is an erstwhile goal, there is a need to put in place a number of building blocks for coherent policy initiatives to be respected and ultimately bear fruits.

It may appear a bit impatient to consider a FTA right from the beginning, given that there are several efforts have already been made to set up FTA among smaller group of countries. A case in point is the initiative to form an FTA among ASEAN economies, China, S Korea and Japan, simply known as ASEAN Plus Three (APT). Proponents of 'gradualism' in the formation of Asian Economic Community (AEC), favour a sequential approach in expanding the membership of an initial East Asian FTA. With AFTA already in place, APT is viewed by many as the next 'logical' phase⁵. The next stage then involves the accession of another three economies: India, Australia and New Zealand. The configuration in the latter stage involves all the economies included in CEPEA⁶. Basically the process can be described as ASEAN+3+3 path to economic integration.

However, such an approach is overly 'deterministic' in the evolution of an AEC. It may result in 'still birth' especially when economic benefits perceived or otherwise are unable to overwhelm the negative historical residual encumbrances. The inclusion of developed economies in the configuration, as what CEPEA would entail, makes the differences in the level of economic development even more conspicuous, and the lack of complementarity more pronounced. Furthermore, there is a perception that 'late-joiners' to a club will likely to be disadvantaged. The 'late-joiners' may not like nor can it be in a position to accede to all the agreements settled in the APT.

The report of the CEPEA Study Group during Phase I did not treat APT and CEPEA as alternative to one another. In fact, there is friendly cooperation, exchange of views and mutual consultation by experts who are involved in the two study groups. It affirms that co-existence of both regional entities is tolerated and their ultimate goals can be reconciled and are coterminous. While one can think of 'starting afresh' with ASEAN+6 as a feasible FTA item, the idea of encompassing APT within an OECD type organization comprising of CEPEA members worth serious consideration and discussion.

⁴ This section is heavily adapted from the country report in the first phase of study.

⁵ There is also an alternative view that following AFTA, the 'ASEAN + 1' FTAs will provide the basis for APT which can possibly evolved from the amalgamation of the 'ASEAN+1' FTAs.

⁶ There is a possibility that the CEPEA membership may increase to include other countries like Mongolia and Russia.

Following the OECD, CEPEA can provide a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and coordinate domestic and international policies. It is a forum where **peer pressure** can act as a powerful incentive to improve policy. CEPEA helps governments to foster prosperity and fight poverty through economic growth, financial stability, trade and investment, technology, innovation, entrepreneurship and development co-operation. It is helping to ensure that environmental implications of economic and social development are taken into account. As in the OECD, some members have the freedom to form or to be part of FTAs, custom unions, and economic community.

One can envisage the CEPEA OECD to be a platform for more **action-oriented, in-depth collaboration** in 'immediate' and functional region-wide issues (often with global implications), such as climatic change related policies, energy (oil) collaboration, financial swaps, pandemics control, and pan region **double taxation agreement**. In the area of trade liberalization, it can make small but significant step forward by considering the WTO Information Technology Agreement (ITA). The ITA provides for participants to completely eliminate duties on IT products covered by the Agreement. CEPEA can remain WTO consistent and also WTO-plus, if it can agree to implement the WTO ITA with a wider range, if not all IT products. It will be a '*Comprehensive ITA*' in the CEPEA region. With similar *modus operandi*, other product lines can be explored. As it makes progress, overlapping concern and interest will lead to convergence in objectives aspiration. CEPEA as a FTA can be one the objectives.

5. Possible programs and initiatives under CEPEA as 'OECD of the East'

CEPEA is in need of more permanent body like a Secretariat that act as a focal point for raising issues and working diligently towards solutions and best practices.

Integration into the global economy is not just desirable but also a necessary and inevitable modality for ensuring economic viability and survival in a highly competitive global market place. The member states of CEPEA, therefore, need to devise and implement a strategy, which not only protect them from the negative effects of the globalization, but also help them to conform and adapt with the requirements of the global economic system.

One can imagine CEPEA OECD task is full of challenges stemming essentially from the inherent economic structures and policy frameworks of the CEPEA member states. The CEPEA grouping includes a diverse range of economies, each at different stages of economic development, market and institutional majority and openness to trade and investment flows. It was only a few years ago that member states began to accept open and outward looking policies to attract foreign investments and promotion of international trade such that domestic growth and development can be facilitated. Problems involving customs and procedures often posed serious impediments to routine operations of business involved in intra-regional trade. According to an UNCTAD study as well as an APEC study, import documentations and other

formalities add 7 to 10 percent to the cost of goods traded by the developing economies. The need for simplification and harmonization of customs rules and procedures and rationalization of tariff structures is quite apparent for CEPEA member states, many of whom are looking forward for relief from high transaction costs arising from arcane custom rules and regulations.

In pursuance of these objectives (cooperation, facilitation and liberalization), a number of projects and programs can be thought of. The idea behind these projects/program is to lay down the necessary regulatory framework, in a region-wide context, which facilitates and allows the business communities of the CEPEA region to exploit the emerging opportunities.

6. Cooperation

Customs and Transit Trade Cooperation also plays an important role in economic cooperation among CEPEA Member States. Members will have to simplify and harmonize custom procedures such that transaction costs are reduced and expansion of trade is encouraged. In the same vein, there will be cogent need to follow the effective implementation and further updating/expanding the scope of agreement on simplification of visa procedures for businesspersons of member states to facilitate the contact, communication and trade in CEPEA economies.

The enforcement of industrial standards in the CEPEA region is in line with international standards and improvement of quality management systems according to International Standards Systems (ISS). In this regard, efforts can be made in the direction of having mutual recognition agreements (MRA) in the areas of product safety regulations, education qualifications, technical standards, and health status certification. Such agreements can contribute to the removal of non-tariff barriers, reduction of transaction costs, encouragement to movement of professionals and skill transfer across borders.

7. Project for Trade Promotion & Investment

CEPEA Secretariat can launch a joint project aimed at expanding intra-regional trade. The project can focus on identification of trade & investment opportunities in the region and creation of an enabling environment to bring together buyers and sellers of selected product groups. Such project can be led or supported by the Chambers of Commerce and Industry in respective member countries. Infrastructural development and construction will be one critical area in which mutual aid, investment opportunities, and technology transfer can be made available for economic cooperation and business ventures.

8. Trade Facilitation

One can envisage CEPEA members to consider Transit Trade Agreement and Transit Transport Framework Agreement. Such agreements aimed to facilitate trade between member states via transit through other member states. It is applicable to road, railway, sea, air or any combination of them. For instance, a pan region open-sky policy will be one that promotes travel and boosts tourism industry development. Goods transported under the Agreement are subject to import/export duties and taxes. Goods shall not be subject to examination through Customs en route. Customs offices will accept the validity of CEPEA Passage Document in order to avail facilities under the Agreement.

9. Trade Liberalization

The main thrust of the work in the field of trade liberalization has been towards the reduction of tariffs and removal of non-tariff barriers in the CEPEA region. As it moves on for in-depth integration, other trade related issues will feature in the agenda: TRIP, TRIM, government procurement, trade financing and insurance. While trade does not obviate the need for large scale supported development investments, an open and equitable trading system is reckoned to be a powerful driver of economic growth in CEPEA, especially when combined with adequate political support. Started in 1994, it took ASEAN 10 years for the founding 5 members to reduce tariff to between 0% and 5%. The other 5 'late comers' to ASEAN are given extra two or three to attain the same level of tariff removal. The experience of ASEAN can be of tremendous help to forge and develop CEPEA into a FTA en route to an Asian Economic Community

10. Conclusion

CEPEA is an integrated framework composed of measures for the three pillars, namely, cooperation, facilitation and liberalization. All three pillars complementarily serve to achieve CEPEA's objectives of deepening economic integration, narrowing development gaps, and realizing sustainable development.

In order for it to continue to flourish, CEPEA is recommended to evolve into an OECD type organization to foster economic cooperation, promoting an enabling environment for enhanced economic liberalization in trade, investment and skilled labor, which will lead to the formation of a FTA and eventually an Asian Economic Community.

Thailand

Thailand

Suthiphand Chirathivat
Chulalongkorn University

1. Context

The Asian-wide region has generally been becoming more outward-oriented economies with a more deepening economic integration at the regional level. However, regional cooperation, still, has to catch up with so many new challenges facing the region in different areas of development. The latest global financial crisis serves as another example of how such a broader regional cooperation is necessary and useful to create ways for alleviating such an impact and to coordinate for a better regional and global financial architecture.

CEPEA has expressed clear objectives to become a broader regional cooperation, from its beginning, to narrowing development gaps, deepening economic integration, and achieving sustainable development. These objectives are still to prove as viable regional initiatives looking to improve the likelihood of people, the use of its resources and environment, to fulfill its ends goals, as a more equitable and harmonious development, for the region in the long run. To achieve CEPEA objectives, economic cooperation, trade and investment facilitation and trade and investment liberalization are all considered as three pillars of these new initiatives. Only after the ministers meeting of the EAS countries in 2008 agreed to a Phase II Study on CEPEA, so the detailed works of track II begin to include as well the issues of institutional developments.

Although there exists a number of regional and sub-regional cooperation and arrangements, still, in recent years, and more to come, there are several new challenges that these countries experience in so many areas of development that the existing regional institutions may not be able to cater with such developments. Whether it is economic, social, cultural, environmental concerns of all sorts, it seems to be that there is enough scope for broader regional cooperation that will take place. It remains to be seen how CEPEA would like to take its course to achieve such objectives.

2. Scope for Regional Cooperation

Since the last Asian financial crisis of 1997-98, a scope for broader regional cooperation has become a reality, firstly, through the Chiang Mai Initiatives (CMI), in the areas of monetary cooperation. Afterwards, countries in the region have seen the importance to cover other areas of development. From the process of ASEAN plus 3 development, to the first EAS meeting, the

process of ASEAN plus 6 was born and has also become the latest broader regional cooperation in Asia.

ASEAN has played a key role in the formation of such process and expects to continue to do so. Other non-ASEAN countries see ASEAN in the driver's seat perhaps because of the achievements of ASEAN as a regional organization and the existing mechanisms and institutions of ASEAN that help to create such a dialogue with different partners. These advantages have helped ASEAN to project such a realistic view like the new process of ASEAN plus 3 or ASEAN plus 6 in consistence with other developments of regional and sub-regional institutional framework. To some, this might represent the ASEAN First and the ASEAN centrality in the sense that any future broader regional cooperation can not neglect the role playing by ASEAN.

In general, ASEAN might like to see an evolution approach to any broader regional cooperation that will take place. And in no way, ASEAN would like to cause a conflict of such both current undertaking processes. The question is in what possible best way ASEAN could be active and useful in such processes of broader regional cooperation in order to be a major part of broader regional achievements in the future.

For the moment, ASEAN is seeing CEPEA can help to fulfill these broadly three goals with its major pillars, ranging from economic cooperation, then extending to trade and investment cooperation and finally taking challenges on trade and investment liberalization.

3. Suggestions

With the current framework of CEPEA Phase II, it remains to work out further details of its three key elements; economic cooperation, facilitation and liberalization. Also, institutional development to assist the executions of these three elements represents a necessity in this approach.

Regarding economic cooperation, there are several important areas that the study should focus like agriculture, food, health, tourism, energy, transport, environment and HRD. Development gaps among countries and regions still exist and should be an integral part of this element. Developed countries should play all along such a constructive role to assist developing countries in the region and such cooperation should not be served as a tool to negotiate for other elements like market access or openness.

It is essential for the study to consider all sorts of trade facilitation that are already operated, agreed or negotiated at the regional level. In particular, the added value that the process can bring should give a high priority like the complexity of the Rules of Origin (ROO) as a result of proliferating FTA/EPA arrangements that cause to the private sector. It should also consider other areas of facilitation to help reduce economic transaction costs like custom formalities,

single window/one stop services and business travel facilitation. There should be improvement in the region as well for the mobility of high/semi-skilled workers by investigating the possibilities of mutual recognition arrangements. The study could explore as well potential issues like competition policy, government procurement in a non-binding manner that would encourage developing countries to participate more actively in the process.

The most critical element; liberalization of trade and development, especially for developing countries, has to be dealt with the broadening from the scope of ASEAN plus one. To move beyond the ASEAN plus one process, it is essential to harmonize benefits and rules governed and to make the new commitments a la “WTO Plus”.

Any attempts to trade and investment liberalization should not be a single undertaking process. Negotiations for liberalization should start with trade in goods for example, before extending to other areas like trade in services, investment, or so on. It should also consider an approach like ASEAN plus X for countries not ready to be in at the beginning, and/or another approach like special and differential treatment (S&D) for developing countries in consistence with the WTO.

In the longer run, element of liberalization in trade and investment should help the region to foster its competitiveness and achieving its CEPEA objectives. It should not force or take too early investment liberalization, for example, without a proper balance of investment promotion and protection, with lots of exercises to working out in technology transfer, spillovers and know how in addition to the capacity building and exchange information among countries involved.

Like any institutional development in the region, the study could learn much from other existing institutions elsewhere like the OECD, and also the ones from the region like ADB, ASEAN Secretariat or ESCAP, to cite a few of them. At the same time, it is necessary to formulate a proper structure that suits its future works and programs that might be unique and respond better to the future needs of the region.

Note: The author would like to thank Dr.Chackrit Duangphastra and Ms.Patcharakarn Whanchid for their helpful comments and useful information. All errors remain with the author.

Viet Nam

Vietnam

Bui Truong Giang

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Vietnamese perspectives on CEPEA and EAFTA

We share with other CEPEA study group members on the need to clarify the “value added” of CEPEA vis-à-vis the EAFTA. We do think that CEPEA is necessary for strengthening economic and development cooperation among the 16 countries, but for now CEPEA roadmap should take gradual and functional approaches to be compatible with other ASEAN+1 processes.

For the benefits of facilitation and liberalization to all members to be realized, in the time to come we recommend that CEPEA initiative should be further studies in terms of social impacts and other possible outcomes to member countries – such as environmental impacts and labor implications, once the CEPEA is to be formalized or institutionalized into a series of key regional arrangements.

The CLMV countries are still LDCs, which are under-capacity to engage and implement a series of FTA commitments, not to mention CEPEA and EAFTA ventures. For better narrowing the development gaps, we do suggest that the future EAFTA and CEPEA frameworks should provide a special vehicle or mechanism for the CLMV to better participating into such regional arrangements as CEPEA and EAFTA. For example, advanced countries like Japan and R.O. Korea or emerging large economies such as China and India should create a “window of opportunity” for the CLMV themselves to early and better utilize the benefits from implementing the future CEPEA and EAFTA arrangements and initiatives.

For comprehensiveness and sustainable development, we do suggest that the CEPEA and EAFTA study groups should take into consideration the content of “rural development for CLMV” in the fields of economic and development cooperation, as the CLMV could only successfully integrate into the future CEPEA and EAFTA arrangements once the rural areas are to be smoothly shifted towards industrialization and integration. To this end, infrastructure investments and vocational trainings are key determinants for such transition.

Appendix. 3

Additional Inputs from Experts

- Regional Cooperation (Australia, New Zealand)
- Human Resources in East Asia: Unequal Starting Conditions, Future Development Challenges, Vision on EAS Cooperation (Indonesia)
- Regional Cooperation on ICT (Malaysia)
- Economic Cooperation Involving ASEAN and the Countries Participating in the EAS Process (ASEAN Secretariat)
- Facilitation Opportunities in CEPEA (Australia, New Zealand, Malaysia)
- Input to CEPEA on Rules of Origin (India)
- Government procurement, IP and CP (Malaysia, New Zealand)
- Potential Benefits of the Liberalization of Labour Movement (Australia)
- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)
- New Paradigm of Economic Growth: Global Value Chain and Global Production Network (Singapore)

Regional Cooperation (Australia, New Zealand)

Australia

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New Zealand

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New Zealand Institute of Economic Research

Regional Cooperation

Using CEPEA to build on existing regional cooperation programs

Members of the Study Group are of the view that in order to add value cooperation through CEPEA should build on existing cooperative efforts in the region. We should be looking at how adding six countries to the ASEAN mix helps to reach economies of scale. The logical starting points are the cooperation programs in ASEAN and in the “ASEAN Plus One” agreements.

1. Information and Communications Technologies (ICT)

One area that has seen considerable cooperation in recent years is regional work on ICT questions, including e-commerce. Through the ASEAN Australia Development Cooperation Program (AADCP), considerable work has been undertaken aimed at developing the legal infrastructure for e-commerce in ASEAN. The project, as originally conceived focussed on the core issue of legal recognition of e-commerce, but participants later enlarged the project to include a three-phase approach addressed to: harmonization of e-commerce legal infrastructure (2004-2005); online contract formation and online dispute resolution (2006); and mutual recognition of digital signatures (2007).

The recently signed ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) incorporates a chapter on electronic commerce that obliges member governments to maintain or adopt domestic laws and regulations governing electronic transactions, including measures addressed to electronic authentication and digital certificates, online consumer and data protection, and to take steps toward a paperless trading environment. The chapter also encourages ICT-related cooperation in research and training activities targeted, *inter alia*, at assisting SMEs in overcoming obstacles encountered in the use of electronic commerce and

exploring ways in which developed Parties to AANZFTA could provide assistance to developing Parties in implementing an electronic commerce legal framework.

Following on the ongoing work being done under the auspices of AADCP and the newer initiatives launched as part of AANZFTA, CEPEA could be used to deepen the cooperation in the region and also to extend it to economies not now collaborating on ICT work. Suggestions for work where CEPEA-wide cooperation could add value include:

- Work towards common technical specifications and standards for ICT infrastructure to ensure interoperability;
- Work to ensure consistency among laws and policies relating to e-commerce, electronic data submissions, digital signatures, personal data protection and trade facilitation techniques;
- Collaboration and support in application of new technologies to support the development of e-logistics in the region; and,
- Capacity-building programs for personnel in less-developed economies and assistance to SMEs in the effective use of the latest technologies.

2. Competition

Another area of developing cooperation in recent year is regional work on the promotion of competition, economic efficiency, consumer welfare and the curtailment of anti-competitive practices. Again, AANZFTA provides an indication of the scope of what CEPEA could encompass. It contains a chapter on competition that covers the establishment of contact points, exchange of information and experience in the promotion and enforcement of competition law and policy, and exchanges of officials for training purposes. There are also provisions for Australia and New Zealand to assist ASEAN countries with implementation of the chapter.

Human Resources in East Asia:
Unequal Starting Conditions,
Future Development Challenges,
Vision on EAS Cooperation
(Indonesia)

Indonesia

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Making Humans a Binding Tie:

Facing Up the Challenges of East Asian Cooperation in Human Resources

The Human Resource Divides

East Asia Summit Countries of the early 2000s are faced with stark contrasts despite some signs of convergence and multiple initiatives on an accelerating catching up. The sticky gap is well known to politicians and scholars. National, regional and global rounds after of poverty eradication program have launched in over 60 years after World War II. Narrowing the gap between developed countries and developing ones has indeed been made an element in almost all elements of international relations, including global and regional trade agreements. The paradigm evolves continuously. There were times when priority was attached to meeting basic needs. A different approach was launched in the late 1960s under the heading of “development through trade” where manufactures originating in developing countries are granted easier access in developed countries’ markets. The story of the East Asian success is to a large extent one of preferential trade opening which in due course of time triggers a large-scale manufacturing relocation to the developing East Asia. Old paradigms of cooperation may be reinvented or new ones may even emerge. However, development catching up will remain probabilistic. It takes huge efforts under a favorable external environment for a catching up strategy to work sustainably. Whatever the approach is called its success depends crucially on the human capital edge that the catching up countries is capable to harness. Whether one talks about cooperation, facilitation or liberalization the centrality of human capital accumulation as prerequisite of success is well acknowledged. In all walks of life champions are successful accumulators of human capital. What is more human capital is apparently the most durable form of capital. Its cross-border flows leave a lasting footprint of people-to-people connection. Unlike gold human capital is more difficult to misappropriate. Benefits of a rising stock of human capital is spread very widely unlike those of a physical building that owner can internalize completely. Human resources development or human capital accumulation is, therefore, is very promising field for inter-governmental co-operation and has, in fact, occupied a very high rank in the priorities of development co-operation.

The development gap that separates the 16 countries in the East Asia Summit from one another is well known. In terms of per capita GDP in 2007 international PPP dollar Brunei Darussalam, Singapore, Australia, Japan, New Zealand and Republic of Korea form a small club of countries

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with per capita GDP ranging from \$ 24801 in the Republic of Korea to \$ 50199 in Brunei Darussalam. These high-income countries account for only 6.4 percent of the total population of the East Asia Summit area. Malaysia can be grouped as a middle-income economy, but add only another 1 percent in terms of population. The rest of EAS economies have to struggle with a per capita income, which is lower than world average. Furthermore, the gap that separate Japan as the richest populous economy within EAS with a per capita GDP of \$ 33632 from China, India and Indonesia with a per capita GDP below world average but together account for 83 percent of EAS population is truly enormous. Issues of development gap are aggravated by an even lower output in Lao, PDR, Cambodia and Myanmar and apparent entrapment of Myanmar in stagnant development, however difficult it is to judge on Myanmar's development given the lack of recent indicators. Under such a deep gap one has to stretch every imagination to arrive at agreements that are perceived to be of mutual benefits for both ends of the spectrum.

The proposed CEPEA's tripod looks to fit with the prevailing circumstances in EAS countries in that cooperation is attached at least the same importance as integration. Unfortunately, proposing a binding commitment in co-operation is far less straightforward than it is for integration. First of all, the enormity of development issues makes any co-operation initiative look like a drop in vast ocean. It is perhaps the perceived limited benefits that discourage governments from pursuing speedy implementation of the numerous cooperation agreements between ASEAN and the rest of the world, particularly its external dialogue partners. Secondly, co-operation requires in most cases funding commitment which governments prefer to make on a bilateral basis rather than regionally. Thirdly, EAS countries are faced with a huge imbalance in terms of potential to contribute to the financing of cooperation in spite of the rapid speed at which China, India, ASEAN-4 and Vietnam are catching up. Designing co-operation under such circumstances is a herculean job. Yet, experiences with regional and sector cooperation under the umbrella of the European Communities, later Union, indicate that acceleration of catching is probable under a proper mix of co-operation, integration and facilitation.

Enhancing productive capacity rather than artificially raising consumption has been accepted as the core principles of good co-operation. The core element of productive capacity is, in turn, human capital understood as the net present value of income that people, individually and as collective, can generate throughout their productive life, net of natural resources depletion and consumption of produced physical capital. In a study on the wealth of nations the World Bank arrives at some interesting figures. The gap that one sees in income is generally found in wealth. Within EAS countries per capita wealth is highest in Japan at PPP \$ 493241 in 2000 before Australia at \$ 371071, Singapore \$ 252607. In the middle we have Malaysia and Thailand with per capita wealth of \$ 46687 and \$ 35854 respectively and at the lower end Indonesia at \$ 13869, China \$ 9387 and India \$ 6820. Figures are not available for CLMV. The composition of per capita wealth shifts in favor of intangible capital, the residue after natural capital and produced capital, as income rises. Intangible capital comprises 77.8 percent of Australia's per capita wealth, 69.2 percent of Japan's wealth, but only 57.8 percent of Indonesia's wealth, 54.8 percent of India's wealth and 44.8 percent of China's wealth. Intangible capital can take different forms such as patents, trade mark, and copy rights. Its main ingredient is human creativity and innovativeness. Co-operation under EAS initiatives should, therefore, be centered on human

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capital formation and accumulation. Yet, human resources development is an immense field, spread all over walks of life, all spatial units and all stages of the human life cycle.

Human capital of a country can be gauged with the help of three groups of indicators: health, educational attainment, and entrepreneurship, the last group being a proxy for the use of knowledge and skills. If the relation between population and human resources is linear EAS countries would by far be the richest in the world. Apparently, the relation is anything but linear. Which element should be discussed first is also akin to chicken or egg. Health is an input to education in as far as it affects human accomplishments in education. On the other hand, the health of an unborn baby is partly dependent on the education of the mother. In the section that follows health is discussed first before education and entrepreneurship.

One of the most comprehensive yardsticks of health is life expectancy at birth. Longer life can be understood to mean longer working life. On this score EAS countries are led by Japan with 83 years, followed by Australia with 82, New Zealand and Singapore with 80 each and South Korea with 79. In the middle there live China, Malaysia, Thailand, Vietnam, the Philippines and Indonesia with life expectancy ranging from 68 in Indonesia to 73 in China. Indians, Cambodians, Laotians and Burmese live significantly shorter, namely closer to 60 years. Life expectancy is usually positively related with health. Longer life expectancy is a logical consequence of improving health. However, life expectancy can be adjusted with health to arrive at Health Adjusted Life Expectancy (HALE). It roughly tells how long people live a healthy life. On this score the top 5 within EAS is occupied by Japan at 75, Australia 73, New Zealand 71, Singapore 70 and South Korea at 68. The middle group consists of Chinese at 64, Malaysians at 63, Vietnamese at 61, Thais at 60, Philippines at 59 and Indonesians at 58. Health-adjusted life expectancy is only 53 years for Indians, 52 years for Burmese, 48 years for Cambodians and 47 years for Laotians. Years of life can be lost because of premature death and burden of diseases. Put together they are converted into DALYs (Disability Adjusted Life Years). DALYs are as long as 0.4 per population of Lao, PDR in 2002, 0.38 for Cambodia, 0.3 for Myanmar, and 0.29 for India. Indonesia and China suffer from DALYs of 0.21 and 0.15 per population respectively, but the healthiest countries of Japan and Australia lost only 0.1 and 0.11 per population. Both numbers of HALE and DALYs tell about losses of life expectancy.

Interpreting differences in life expectancy, HALE and DALYs is difficult. What is it that one can say in economic terms about the longer HALE of the Japanese than that of the rest of East Asians? Given Indian population of 1124787 thousands, the Japanese's HALE of 75 and Indian's HALE of 53 and an implicit foregone HALE of 24.7 billion, can something meaningful be squeezed out these numbers? The optimal length of life is largely unknown. Relatives of an aged human being are usually willing to pay a large sum for the latest medical technology. There must have been strong evolutionary reasons for such behavior. If what counts in life is the share in the gene pool as argued by some geneticists, and if that share depends on fitness or probability of reproducing successfully, living longer beyond reproduction age may not be the best strategy to maximize share in the gene pool. Be it as it may, the rise in life expectancy from around thirty at the start of Current Era to over eighty in the case of the Japanese in early 21st century is widely considered one of the greatest human accomplishments. It is possible to statistically attach a pecuniary value to human life. One can multiply length of life with the

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Statistical Value of Life (SVL) which can be gauged on the basis of the amount of money that a person is willing to pay for an extension of life by one unit of time as it is implicitly done in insurance, to obtain an estimate on the total value of a population.

Longer HALE does indicate the competitiveness of a country to provide for its people the tangible and intangible ingredients of a healthy life. The ingredients are extremely manifold and relate to one another in intricate ways. The tangible ingredients start with the living environment, housing, access to treated water, excretion facility, genetic distance between husband and wife, maternal nutrition during pregnancy, child nutrition, access to vaccines and vitamins, access to social amenities, including sport facilities, access to health facilities in times of sickness and a lot of other ingredients that get more diversified as one climbs up the life cycle. On the other hand the intake of certain ingredients beyond a certain quantity affects health in a harmful way. Tobacco is connected with diverse diseases and is even called a time bomb in a 2008 study by the World Bank. Its incidence tends to decline with per capita income. EAS countries are home to most active consumers of tobacco. Other health-phobic substances include alcohol, excessive fat, and abused narcotics. Physiological capital of a person such as body-mass index, height and physical dexterity depends to an important degree on the intake of tangible ingredients. Educational attainment has been found, for instance, to be positively related with body weight at the time of birth. Under weight is statistically correlated with lower attainment.

A myriad of intangible ingredients go to HALE. Life style is one of the most generic among them. The intake of health-phobic substances is part of life style, which in turn is at least partially affected by government policies. Dependence on tobacco excise revenue is often time quoted to defend a very puzzling policy of compulsory statement on the harmful effects of tobacco and alcohol on the one hand and toleration of extensive emotional advertisement on public properties such as busy intersections and government-sanctioned sport events. Education is undoubtedly a very important ingredient to health. The educational attainment of a mother is bound to affect the health of her descendents for a very long time. Health literacy is a very important element of inputs to health and should be sought at the earliest stages of the life cycle.

The health gap as reflected in HALE or DALYs of East Asians can further be broken down to more varied indicators such as access to piped water, education of mothers in the fertile cohorts, early births, underweight at births, attended by medical professionals, infant mortality, incidence of malnutrition, health facilities per population and areas, medical doctors and nurses per population and many other indicators. The wide gap that one finds in HALE and DALYs is also reflected in health ingredients. The pattern is more or less straight forward. Poor countries fare poorly in terms of HALE, DALYs and other health indicators.

The following is just an illustration of the gap in health inputs in the period of 2004-2006. Access to improved water sources is universal in Australia, Japan, Singapore and over 90% in Malaysia, Thailand, the Philippines and Vietnam but is only 65% in Cambodia and even 60% in Lao, PDR. Likewise, access to improved sanitation is universal in Australia, Japan and Singapore, but only 48% in Lao, PDR, and 28% in Cambodia and India respectively. Life expectancy at birth ranges from 60 in Lao, PDR to 83 in Japan, a difference of 23 years. Only 3 out of 1000 births in Singapore, 4 in Japan, 5 in Australia, Republic of Korea and New Zealand

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die in infancy, but 79 in Lao, PDR, 74 in Myanmar, 65 in Cambodia and 57 in India. Children failing to survive 5th life's year are as many as 121 out of every thousand in Lao, PDR, 103 in Myanmar, 89 in India and 82 in Cambodia, but only 3 in Singapore, 4 in Japan, 5 in Republic of Korea, and 6 in Australia and New Zealand. In the age of 5 or less over 40% of children are stunted in Lao, PDR, India, Myanmar and Cambodia.

Given the severe gap health improvement should have been given a strong and durable push in severely lagging countries. There are signs that health is being elevated to higher rank in household and government expenditures. Lao, PDR and Cambodia spent on health in 2005 no less than 3.6% and 6.4% of GDP. However, health is relatively sticky as an issue of development. Catching up at a rapid rate is improbable in health. For obscured reasons people spend more on health as they get richer. New Zealand spends 8.9%, Australia 8.8% and Japan 8.2% on health in 2005. Resource availability cannot be the entire explanation for such a positive relation between income and health. Equally puzzling is government inclination to spend on health in that their commitment to health is positively related to per capita income and health status. Government shares in total health expenditures are as high as 82.2% in Japan, 77% in New Zealand, 64% in Thailand and 53% in Republic of Korea, but only 24% in Cambodia, 21% in Lao, PDR, and 10.6% in Myanmar. Health accounts for 18% of total government expenditures in New Zealand, 17.8% in Japan and 17% in Australia, but only 4.1% in Lao, PDR, and 1.1% in Myanmar.

Health can perhaps be called the prime element of human capital. Before the arrival of culture health as reflected in physiological capital is the currency of survival. More healthy members of a group secure a better access to mating and reproduction than less healthy ones. While culture such as philanthropy, altruism, co-operation and medical technologies has immensely reduced the limiting impacts of physical disabilities some elements of intangible capita, such as schooling-based knowledge and skills, have remained more accessible with better health. Access to employment is usually made conditional on health such as height, body-mass index, color blindness, and freedom from certain diseases. On the other hand, nurtured competencies have greatly gained in importance as the knowledge intensity of life in general and its science intensity in particular are rising. Proper education and training can compensate for a lot of shortcomings that stem from physical conditions.

Ideally speaking educational attainment should be measured in terms of literacy or mastery of general and scientific knowledge, hard skills and soft skills. However, statistics on the mastery of knowledge and skills are available only very partially and in scattered forms. For practical purposes other indicators are more accessible.

The East Asian stories about human resources development are mixed. Long ago, East Asia was said to suffer from over population that hinders the progression to higher per capita income. While perception about East Asian population has changed some difficult issues persist. The share of EAS countries in world population will remain very high in 2020 at 47%. Of the latter 87% agglomerate in China and India and another 14% in the next three most populous countries of Indonesia, Japan and the Philippines. The other 11 countries share only 9% of the region's population. The picture of world labor force looks similar. The share of EAS countries in world

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population in the cohorts of 15 years and over will remain high at 49.7% in 2020 down only slightly from 50.3% in 2010. Of the nearly 700 million addition to world population in the group of 15 years and older between 2010 and 2020 44.8 percent will come from EAS countries. Of the increase in EAS countries almost 86 percent will be Chinese, Indians and Indonesians. Large population number does signal survival advantage of a group such as ability to feed members. On the other hand large population poses some difficult problems in an increasingly science-driven world. Enormous resources will have to be invested in education, health and entrepreneurship to enable large population to compete successfully.

Information on education is available from myriad of sources. UNESCO maintains a large-scale online database. Education is also reported by the International Labor Office for labor force and by World Health Organization in relation to the impacts of parent education on child health. World Bank's Development Indicators also include some series on educational attainment and educational resources. Needless to say, National Bureaus of Statistics compile extensive data on education. However, not all series are available for the sixteen EAS countries. Statistics are also hard to compare. One year of schooling may mean different length in terms of hours of teaching or amount of resources spent. Some figures look suspiciously small or big. Caution is therefore needed in interpreting educational statistics.

Imbalance is unmistakable in the human capital of EAS countries. Some countries are known for their very strong propensity to invest in education. They include Japan, Republic of Korea, Singapore, Australia, New Zealand and Malaysia. Others are yet to earn such reputation. East Asian good record in education is well known. However, enormous challenges still lie ahead. School life expectancy from primary to tertiary education is highest in Australia at 20.5 followed by New Zealand at 19.5, Republic of Korea 16.6, Japan 15 and Brunei Darussalam at 14. In the middle one finds Indonesia at 11.6, the Philippines at 11.8 and China 11.2. Despite a strong reputation as investor in education school life expectancy from primary to tertiary is lower in India at 10. Lao, PDR ranks lowest within EAS countries at 9.2. The gap is also reflected in enrollment in secondary and tertiary education. Republic of Korea and New Zealand rank highest in terms of tertiary enrollment at 93% and 80% respectively ahead of Australia at 73%, Japan 57%, Thailand 50%, the Philippines 28% and China 22%. India and Indonesia lag at a distance with a ratio of 17% and 12% respectively. Cambodia with 5 percent and Lao, PDR at 9% lag farthest behind.

The countries of EAS differ starkly in terms of inputs dedicated to education. Expenditures on educational institutions as fraction of GDP ranges from as low as 1.5% for Indonesia (this number looks suspiciously low) to 7.2% for the Republic of Korea, the highest among EAS countries. Apparently East Asians value education differently. Involvement in financing educational expenditures also differs starkly among governments in the regions. Governments of OECD members in the region shoulder over 70 percent of total expenditures on educational institutions. In the case of New Zealand the share of government in educational expenditure is even higher at almost 81 percent. On the other hand government shares in educational expenditures is moderately lower in Indonesia at 64.3 percent or even lower in the Republic of Korea at 60.5 percent, revealing that the reputation of South Korea as champion of education is attributable to households endeavors to a greater extent than it is in the rest of EAS countries.

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Expressed as the ratio of expenditure on educational institutions from primary to tertiary institutions to per capita GDP, both in US PPP dollars, average propensity to invest in education is highest in the Republic of Korea at 0.29, followed by Japan at 0.28, Australia at 0.26, Malaysia and New Zealand at 0.25 and India at 0.22. Among the countries of EAS Indonesia shows the weakest average propensity at 0.06, putting aside countries for which data is not available. How should one comment on the statistical fact that expenditure per student in Indonesia in 2003 of PPP US \$220 is only 2.7 percent of Japan? Under such circumstances catching up is only an illusion.

The same dollar is deployed differently in EAS countries. In Australia, India and the Philippines expenditure per student is mostly routine in nature. Capital expenditure accounts for only 0.8 percent of total per student expenditure in India, 2.3 percent in the Philippines and 9.1 percent in Australia. On the other hand Indonesia spends 10 percent, Japan 15 percent and South Korea 19% on capital expenditure. Under routine expenditure compensation of teachers and other staffs constitute the lion share in most countries. However, the structure of routine expenditures is by no means uniform across borders. In the case Australia, Japan, South Korea and Malaysia a sizable proportion is left to cover other routine expenditures other than compensation of teachers and other staffs. The proportion ranges from 39 percent in Japan to 53 percent in Malaysia. It is puzzlingly low at 1 percent in the case of Indonesia. What teachers and other staffs can accomplish with trivial routine expenditure is one question that needs further exploration.

Ability of educational institutions to attract talents, develop and maintain them determines to an important degree the quality of education. Admittedly, every student brings to learning process certain traits that are given to educational institutions such as intelligence, health and family background as discussed for instance in Charles Murray's controversial *The Bell Curves*. What teachers can do is to add to the pre-school capital the magnitude of which remains a matter of heated disputes. However, arguing that the addition is related positively with qualification and motivation of teachers does sound plausible. Some teachers may choose teaching profession as a call. However, a minimum level of compensation is required to make educational institutions competitive vis-à-vis other employers while competing for superior talents. On this score EAS countries generally offers attractive compensation. Entry salary in primary educational institutions as percentages of per capita GDP is almost 400 in India, 184 in the Philippines, 146 in South Korea and 100 in Australia. Such progressive level must have allowed institutions to set demanding standards for teaching profession. The percentages are lower at 88 in Japan, 82 in Malaysia, 77 in New Zealand and lowest at 72 in Indonesia. The picture looks similar for top salary. India ranks highest with a top-salary to per capita GDP ratio of 615 percent, followed by South Korea at 400 percent, the Philippines at 219%, Japan 211 percent, and Malaysia at 183%. Again Indonesia occupies a low rank at 104 percent.

Educational attainments are more directly linked than educational inputs to economic development and other processes that one wishes to accelerate with the help of education. Unfortunately measuring attainments is formidably difficult. How does one compare 25 years of experience without schooling with 19 years of experience with 6 years of schooling? How does one compare as element of human capital three years of schooling in mechanical engineering

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with the same length of schooling in fishery or even political science? Assigning different weights to different levels of education or using earning differential between different levels of schooling does help as attempted in many studies. However, the problem of measurement remains very complex. Educational institutions do have the tradition to require students to go through exams and to cumulative record grade point average, but testing the latter's correlation with creative, productive and entrepreneurial accomplishments is rarely performed. Though advances in ICT may one day allow a real-time accounting of the stock and changes in human capital due to schooling such approach is a remote possibility for the time being and may not be the best way to proceed.

UNESCO does report on educational attainment. Within EAS countries children reaching Grade 5 have reached 100 percent in Japan, almost 100% in Australia, Malaysia, Republic of Korea and Brunei Darussalam, 92% in Vietnam, 86 percent in China and almost 80 percent in Indonesia and 73 percent in India. Cambodia and Lao, PDR lag far behind with a ratio of 62 percent respectively. Upper secondary graduates as percentage of their cohort have approached 70 in Australia and Japan, exceeding OECD average of 59. Republic of Korea, the Philippines and Thailand are not far behind Australia and Japan, but China, India and Indonesia, the three most populous countries of EAS, do lag far behind with ratios of between 21 and 28. Attainment in tertiary education is highest in New Zealand where tertiary graduates make up 72 percent of relevant cohort compared to 61% in Japan, 59% in Australia, 42% in Malaysia, 40 percent in Thailand, 26% in China and 16% in Indonesia. A more comprehensive picture can be gained from ILO's labor statistics. For every 1000 population in the cohorts of 25-64 years 400 have completed tertiary education in Japan, 317 in Australia, 273 in the Philippines, 135 in Korea and a small 49 in Indonesia. Unfortunately, numbers are not available for the two most populous countries of China and India as well as for CLMV.⁸

The last element of human capital on which the economic status of a person and community of persons greatly depends is entrepreneurship. Health, knowledge and skills get productive only when exercised or used as underlined more than half a century ago by Friedrich von Hayek in his now classic piece titled "The Use of Knowledge in Society". Entrepreneurship is needed to reproduce a useful product using existing knowledge like making cars out of the same technologies or millions of tons of soap using a single formula. This type of entrepreneurship is called "economizing spirit" by Israel Kirzner. A different kind of entrepreneurship is indispensable to harness new scientific discoveries such as the science of stem cell for productive purposes. Indeed, it is probably also entrepreneurship of non-commercial kinds that allow scientists to venture into new paradigms, sometimes at the cost of being condemned as heretics, or politicians to migrate from monarchy to democracy and from totalitarianism to pluralism.

Much has been written on entrepreneurship, mostly in association with capitalist systems. Some trace it back to cultural background or particular changes in it. Unfortunately, something similar to a black box is found in the properties that are understood as ingredients of entrepreneurship. The view that entrepreneurship is largely born rather than acquired and nurtured has largely discouraged empirical studies on entrepreneurship. The fact that entrepreneurs make up only a very small fraction of working population is widely swallowed as fact. The imbalance of wealth

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that in the long progression of time turns in favor of entrepreneurs has been exploited often time for political purposes, particularly in countries where the small class of entrepreneurs happens to consist almost entirely of immigrant citizens like the ethnic Chinese in Indonesia and seemingly also in the rest of Southeast Asia. Policy on entrepreneurship development is largely reduced to affirmative action in favor of groups that are perceived to have been disadvantaged like the “Bumiputra” in Malaysia and poorly defined “indigenous population” in Indonesia. Such pragmatism may have helped enlarge the population of entrepreneurs in some places, but as far as Indonesia is concerned the result has been too meager to justify the distortions that come along with sporadic affirmative action.

The fact that entrepreneur population differs across nations indicate that entrepreneurs can perform differently under different policy settings. Market is a more promising hatchery for entrepreneurs than government intervention, though reality is a mixture of the two. A certain level of regulatory certainty is conducive to entrepreneurship, though not a complete certainty. Policy transparency is good for entrepreneurship, but there is no money to be made under perfect information. Intellectual properties serve as a strong incentive for innovative and creative works, but progress would have been unlikely or at least turned much slower if everything is protected under intellectual property rights. Positive inclination toward wealth accumulation is likely to encourage people to accumulate wealth, but culture that is unrestrictedly permissive to greedy undertaking is likely to turn counterproductive. Fair access to finance is stimulating to enterprise establishment, but financial egalitarianism of the extreme sort would prevent the flow of financial resources to most businesses that serve as backbone of contemporary civilization. To ascertain the degrees of mixtures in the entrepreneurship environment that tends to work best empirical extensive testing is needed. Good entrepreneurship policy is only possible, if it is based on such findings. The alternative is the current practice in most countries where people of talents are expected to respond to stimuli that are implied in open market-friendly policies that governments across the five continents six to establish in the last quarter of a century or so.

Realizing the importance of entrepreneurship to sustainable development the OECD launched in late 2006 its Entrepreneurship Indicators Program following a feasibility study in 2005, the latter under the sponsorship of the Kauffman Foundation. The program seeks to develop indicators for entrepreneurship determinants, entrepreneurial performance and entrepreneurial impacts. The countries covered are limited to OECD members. Entrepreneurship performance is measured in terms of firm-based indicators: employer firm birth rate, employer firm death rate, business churn, net business population growth, survival rate at 3 and 5 years and proportion of 3 and 5 years survival; employment-based indicators: high-growth firm rate by employment, gazelle rate by employment, ownership rate start-ups, ownership rate business population, employment in 3 and 5 years old firms, average firm size after 3 and 5 years; and other that includes high-growth firm by turnover and gazelle rate by turnover. The findings show that entrepreneurship activities have been most active in the transition economies of East Europe where birth rates and one year survival rates are highest in contrast to Italy and the Netherlands where they tend to be low.

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National bureau of statistics of EAS countries do extensively collect statistics that one can use as indicators of entrepreneurship. The last column of the Appendix Table shows that the number of employers as percentage of working population differs across the eleven countries for which data is available. The most entrepreneurial in EAS are obviously the Koreans. Seventy three out of every thousand working Koreans are employer against 26 Japanese, 31 Australians, 33 Indonesians, 34 Malaysians and 65 New Zealanders. Digging deeper into enterprise statistics and labor statistics would undoubtedly allow the measurement of entrepreneurship in EAS countries, but requires formidable statistical works. The variation between countries suggests that EAS countries, too, are open to entrepreneurship promotion under a well-designed policy. Countries may not be as helpless as they are generally believed to be while confronted with the realities of scare entrepreneur. Needless to say, in a region where commercial life is getting linked more and more closely across borders cross-border initiatives on entrepreneurship appear to make sense.

Each of the three elements of human capital has been discussed. Putting them together is even more daunting. A very well educated worker will produce little, if afflicted with severe illness that translates into large DALYs. A healthy worker with low educational attainment is also bound to produce less than a similarly healthy worker with a better education, considering that educational attainments extends productive capacity through the use of tools. A worker with excellent health and excellent education is likely to produce the most, but the differential productivity is hard to gauge. Writing $Y = KH * L * E$ where Y means output, KH health capital and L literacy leaves some very important questions unanswered, notably the exponent that one should assigned to the elements. Supposing that output is a product of the three elements rather than addition one can easily see how differential in one of them would separate countries far and wide within a relatively short period. We see such separation happening in East Asia when Japan pulled ahead before the war, Korea, Singapore and Chinese Taipei in the last 40 years, and a similar process is in the making in China.

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Regional Cooperation on ICT (Malaysia)

Malaysia

Merlyn Kasimir

Regional Cooperation on Information and Communication Technologies (ICT)

The action plans on ICT within ASEAN and between ASEAN and some of its partners in the region could be the basis for some of ICT cooperation programmes and initiatives in CEPEA. The Australia representative has highlighted the regional work on ICT under the ASEAN Australia Development Cooperation Program (AADCP) and AANZFTA.

Some of the other regional work on ICT are outlined below (the measures outlined may not be comprehensive) :

1. ASEAN ICT Action Plan - Building a Connected, Vibrant & Secure ASEAN Community

1.1 ASEAN Information Infrastructure

- a. Enhance the design and standards of the National Information Infrastructure (NII) of Member Countries and ensure their interoperability and interconnectivity
- b. Establish high-speed direct connection between the NIIs, and to evolve this interconnection into the regional AII backbone
- c. Promote security and integrity of the ASEAN Information Infrastructure

1.2 Electronic Commerce & ICT Trade Facilitation

- a. Adopt electronic commerce regulatory and legislative frameworks that create trust and confidence for consumers and facilitate the transformation of ASEAN business to be e-enabled.
- b. Facilitate establishment of mutual recognition of digital signature frameworks.

- c. Facilitate secure regional electronic transactions, payments and settlements, through electronic payment gateways
- d. Promoting and facilitating investments in the production of ICT products and the provision of ICT services.

1.3 E-Society & ICT Capacity Building

- a. Develop an e-Society in ASEAN and capacity building to reduce the digital divide within individual ASEAN Member Countries and amongst ASEAN Member Countries
- b. Implementing capacity building programmes to improve ICT literacy
- c. Facilitating the establishment of a regional mechanism for ICT certification programmes and the cross-certification of these programmes by ICT skills competency countries / agencies
- d. Increasing quality and quantity of professional ICT human resources through capacity building programmes

1.4. Universal Access & E-Government

- a. Providing a wide range of government services and transactions on-line by usage of ICT applications to facilitate linkages between public, private sectors and civil and international organizations
- b. Development of cross-border e-Government application that supports the use of digital signatures from recognized or licensed Certification Authorities (CAs) of each member state
- c. Enhancing the regulatory environment to make ICT affordable and accessible through universally accessible ICT networks
- d. Enhancing inter-governmental cooperation by promoting the use of electronic means in the procurement of goods and services and facilitating freer flow of goods, information and people in ASEAN
- e. Establishing a regional mechanism for “connecting” centers of ICT excellence in ASEAN to facilitate continued dialogues

2. Plan of Action to Implement the Beijing Declaration on ASEAN-China ICT Cooperative Partnership

2.1 ICT Infrastructure Development

a. ASEAN-China Information Superhighway Project:

- Set up ASEAN-China Information Superhighway Working Group, to guide the project feasibility study stage, and plan and steer project implementation in the future.
- Develop ASEAN-China Information Superhighway services and applications taking into account the levels of readiness and specific requirements of the Parties.
- Encourage active participation of business sectors of the Parties.

b. The Next Generation Network (NGN) :

- Study plan for seamless migration from traditional communication network to NGN.
- Conduct studies on policy and regulatory issues to facilitate the deployment of NGN business cooperation and technology standards involved in the migration process.
- Cooperate on standard-setting, R&D and promotion of technology and products of Next Generation Internet (NGI).
- Coordinate efforts of the Parties to address such issues as interconnection and market regulation.

c. Broadband Communications:

- Share experiences on development of broadband communications and Internet applications
- Cooperate and develop multi-lingual and diversified digital contents and multi-media information resources, such as on-line education, tele-medicine, etc.
- Encourage operators of each Party to establish high-speed ASEAN-China Internet Exchange Path (Peering link) and encourage the private-sector to develop internet-based application platform based on the internet development status of the Parties.

d. Radio:

- China to provide training for ASEAN Member Countries on spectrum management, radio monitoring, etc.
- Further strengthen technical exchange and cooperation in such fields as radio frequency planning and coordination, radio monitoring and spectrum management automation.

e. Research & Development

Promote the establishment of R&D Center on Telecommunication Equipment for ASEAN-China markets.

2.2 Universal Service

- a. Cooperate and develop a universal service guide to specify the development goal and strategy of narrowing the digital divide.
- b. Establish the ASEAN-China Telecom Universal Service Forum, which can be considered in conjunction with TELSOM activities, to share best practices and experiences on investment and compensation mechanism, technological means and management skills.
- c. Communications in Rural and Remote Areas:
 - Study ways of telephone and Internet infrastructure building and ways of promoting information services in rural areas.
 - Study the best practices of China's experiences for accelerating the development of rural communication.
 - Develop pilot projects involving application of suitable technologies in rural areas, and promote solutions which are cost-effective, efficient and easy in maintenance.

2.3 Human Capacity Building

- a. Continue the promotion of government-led HRD cooperation through the implementation of China's proposal to provide training for ASEAN mid- and high-level ICT managers and technicians.

Additional Input - Regional Cooperation on ICT (Malaysia)

- b. Leverage private sector's resources in providing training programmes for industry's specific needs.
- c. Promote ICT training in the form of e-learning, and set up on-line schools, e-learning centers and community access center for wider training coverage and sharing of information resources.
- d. . Link up websites of ICT research institutes of the Parties to the existing website for ASEAN-China ICT Cooperation (www.caict.org.cn) for information sharing.
- e. Encourage volunteers to the rural and remote areas of Cambodia, Lao PDR, Myanmar and Viet Nam (CLMV countries) to help the local people get basic ICT knowledge.
- f. Promote the establishment of local training bases in CLMV countries.
- g. Discuss the set-up of ASEAN-China ICT Youth Leaders Forum by expanding the current ASEAN e-Youth Forum to raise awareness and appreciation of ICT and its role in social development.
- h. Organise ICT Contest amongst the young professionals of the Parties.
- i. Encourage the establishment of ICT training bases for small and medium enterprises.

2.4 Network and Information Security

- a. Build upon and strengthen ASEAN cooperation on Network Security (ATRC framework and national CERTs), with the view to improve coordination network and improve the capability of network and information security of the Parties.
- b. Facilitate the joint participation of ASEAN Member Countries and China in the ASEAN CERTs Incidents Drill (ACID) and subsequently explore the establishment of an ASEAN-China Coordination Framework for Network and Information Security Emergency Responses, to, among others, study the handling of cyber-terrorism and other new threats and challenges by conducting emergency response drills and capacity building seminars.
- c. Establish the ASEAN-China Network and Information Security Expert Group and Forum in conjunction with the ATRC Working Group on Network Security or on other occasions for the exchange of latest technologies and best practices.
- d. Cooperate on the R&D and promotion of information security products.

e. Facilitate ASEAN-China sharing of experiences and information on their plans and programmes on awareness of network and information security, i.e. through various means like publication, website, TV programmes.

2.5. Funding

a. The activities mentioned in this Plan of Action are to be mainly funded by the ASEAN-China Cooperation Fund (ACCF). Where possible, the Parties will endeavour to offer necessary resources for co-funding projects, either in kind (i.e. expert speakers or consultants) or in cash (i.e. financial support), within their capability.

b. ASEAN and China will encourage international financial institutions/agencies, development partners and their respective private sectors to participate in the implementation of major projects of interest to them under this Plan of Action.

3. Section Relating to ICT in the ASEAN-Japan Plan of Action

3.1 Intensify cooperation in information and communication technology (ICT) by drawing up medium-term and long-term plans for ASEAN to develop and upgrade Asia's capacity in ICT and to make Asia a global hub in ICT;

3.2 Expand the information flow within Asia, making the region an "information hub" of the world. Recognising the importance of developing the network infrastructure for broadband, facilitating human resource development of ICT, promoting e-commerce and supporting other social and economic activities using ICT, realise the following measures through initiatives such as the "Asia IT Initiative" and the "Asia Broadband Program":

- Taking into consideration benefits of Internet Protocol (IP), wireless technologies, take measures to further develop network infrastructures for broadband to be realised through Japan's support in building domestic and international infrastructure;
- Promote joint R&D and standardisation activities on network infrastructure;
- Take measures to further diffuse broadband with the efforts to ensure the security of networks as well as to share know-how on transition to the latest development of Internet Protocol version that is compatible to the system operated within ASEAN and Japan. Such diffusion of broadband will also be realised through Japan's support for ASEAN's efforts in developing e-Government, e-Learning and other applications through efforts of both sides in developing multi-language translation technologies, in

Additional Input - Regional Cooperation on ICT (Malaysia)

archiving content reflecting Asian cultural heritages and in dialogues regarding ICT policies and regulations;

- Promote professional exchange, capacity building and HRD programmes to upgrade the skills and knowledge of ASEAN ICT professionals and technicians particularly in the areas of new and advanced ICT technologies and creative multimedia; and
- Promote standardisation of ICT applications such as e-Learning, and develop legal infrastructures related to e-Commerce.

Economic Cooperation Involving
ASEAN and the Countries
Participating in the EAS Process
(ASEAN Secretariat)

ASEAN Secretariat

Anna M. Robeniol

Economic Cooperation Involving ASEAN and the Countries Participating in the EAS Process

- Economic cooperation between ASEAN and its Dialogue Partners are covered under different enabling frameworks:
 - Framework Agreements on Comprehensive Economic Cooperation – China, Korea and India
 - Leaders' Joint Statement or Joint Declaration – Plus 3 (China, Japan and Korea)
 - Free Trade Agreements – Japan and, Australia and New Zealand
 - Plans of Action to implement Joint Declarations on Strategic Partnerships – Australia, China, Japan, Korea, India
- Economic cooperation between ASEAN and a Dialogue Partner in some areas has resulted to a number of bilateral (i.e. between ASEAN and that Dialogue Partner) agreements. For example,
 - MOU on Strengthening SPS Cooperation – ASEAN and China
 - MOU on Agricultural Cooperation – ASEAN and China
 - Plan of Action on ICT Cooperative Partnership for Common Development – ASEAN and China
 - MOU on Transport Cooperation – ASEAN and China
 - MOU on Standards and Conformance – ASEAN and CER
- Almost all of ASEAN's economic cooperation agreements with Dialogue Partners have general provisions on that Dialogue Partners' support for ASEAN economic integration, in particular the establishment of the ASEAN Economic Community, and the narrowing of development gaps within ASEAN as well as between ASEAN and that Dialogue Partner
- Economic cooperation between ASEAN and a Dialogue Partners cover a lot of common areas. Aside from the Dialogue Partner support to ASEAN economic integration, cooperative activities are generally aimed at promoting and facilitating trade and investment. In this regard, activities are mostly in the areas of standards, technical regulations, conformity assessment procedures (STRACAP), SPS, other non-tariff measures, simplification of customs procedures and the like. Also common to ASEAN's cooperation and collaboration with Dialogue Partners are activities in the areas of: information and

Additional Input- Economic Cooperation Involving ASEAN and the Countries Participating in the EAS Process (ASEAN Secretariat)

communications technology (ICT), human resource development (HRD), financial cooperation, tourism, transport and logistics, SME development, energy, intellectual property rights (IPRs). Electronic commerce, transfer of technology, competition policy, science and technology are other areas where ASEAN has, in one way or the other, economic cooperation activities with a number of Dialogue Partners.

- Building on existing regional efforts in the areas economic cooperation and trade facilitation should also take into account the work being done in APEC, where 12 economies in the EAS process are members. On the Single Window, for example, APEC has the **Single Window Strategic Plan** adopted in APEC in 2007. The objective of this Strategic Plan is to provide a framework for the development of national Single Window systems to achieve “paperless trading targets and enable seamless data sharing.” ASEAN has an **Agreement to Establish and Implement the ASEAN Single Window (ASW)**, the ASW being defined as the “environment where National Single Windows of Member States operate and integrate.” The National Single Window is basically a system in each Member States, which would allow “single submission of data and information”, synchronized processing of data and information, and single decision-making for customs release and clearance.

APEC also has **Trade Facilitation Action Plans**, which have been fairly successful in bringing down trade transaction costs in APEC member economies.

- Because of the number of FTAs ASEAN is engaged in, there are perceptions that rules of origin in the region have become more complex, with some possible inconsistencies, which do not bode well for the expansion of trade in the region. This therefore makes ROO one of the critical areas for CEPEA – an area where CEPEA could possibly value-add to existing work done at the regional level.

We agree that CEPEA could be the vehicle to consider the potential for harmonizing ROO approaches for goods that are highly traded in the region. We want to caution however that work on ROO involving harmonization, streamlining and/or rationalization may be difficult to sell and to pursue outside the ambit of FTA negotiations.

Without prejudice to the decision that the region’s political masters may take on CEPEA and the FTA it eventually wants to establish, work on ROO could commence in the context of facilitating and enhancing trade within the region. One aspect that CEPEA could look at is on ***cumulation***, which allows products that have obtained originating status in one partner country to be further processed or added to products originating in another partner country as if these have originated in that latter country. ASEAN currently has, aside from its own AFTA, FTAs with China, Japan, Korea, Australia and New Zealand, and soon with India. Each of these FTAs has its own set of ROO and we are not even counting the ROO in the bilateral FTAs within region, e.g. Thailand-Australia, Singapore-Australia, New Zealand-China, P4, etc. Cumulation in all these ROOs is based on bilateral cumulation, meaning, each of ASEAN’s FTA partner can cumulate with ASEAN. Nothing in the current rules would allow them (ASEAN’s FTA partners) to cumulate among each other.

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in the EAS Process (ASEAN Secretariat)

CEPEA could actually look into *diagonal cumulation* and whether this is a possibility within the context of ASEAN's FTAs and CEPEA as a value-added of CEPEA to the current regional initiatives.

- CEPEA is based on three pillars: (i) economic cooperation; (ii) trade and investment facilitation; and (iii) trade and investment liberalization. Again, without prejudice to the decision on pillar (iii), initiatives under pillars (i) and (ii) could be undertaken to substantially reduce if not eliminate obstacles to pursue pillar (iii). Special focus and attention could be given to infrastructure and capability needs of certain countries, in particular the less developed ones. ↻

Facilitation Opportunities in CEPEA (Australia, New Zealand, Malaysia)

Australia

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Malaysia

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Facilitation Opportunities in CEPEA

1. Building on regional trade facilitation initiatives through CEPEA-wide efforts

In the same way that the Study Group sees value added in CEPEA building upon existing cooperation programs in the region, members also believe that CEPEA-wide facilitation initiatives would be most productive where they are based on existing regional efforts. Trade facilitation initiatives in CEPEA could cover areas of “soft infrastructure” such as ROOs, product standards and enhanced customs cooperation, including the establishment of an East Asian Single Window. Hard infrastructure and related services development for facilitating port efficiency and capacity can contribute to facilitation of trade and trade efficiency. However, the areas related to “hard infrastructure” could probably best be addressed under the section of economic cooperation.

CEPEA could build-on and add value to some of the facilitation measures outlined in the ASEAN Economic Community Blueprint , and in the recent ASEAN Trade in Goods Agreement (ATIGA)

2. Rules of Origin (ROO)

Rules of Origin (ROO) issues are widely recognised as key elements in ensuring that trade agreements support regional trade integration. If ROO regimes are not well designed, then they

can impair the ability of tariff liberalization to support regional integration and the development of supply chains.

With “ASEAN Plus One” agreements now finalised with all partners apart from India, work in the CEPEA context could focus on the identification of best practice approaches to the use of rules of origin in regional trade agreements. Taking into account the importance of lowering transaction costs that negatively impact on CEPEA region producers’ participation in global supply chains, CEPEA could be the vehicle to consider the potential for harmonizing ROO approaches for goods that are highly traded in the region.

Like the new AANZFTA, a number of “ASEAN Plus One” FTAs utilizes an approach to rules of origin where the “change in tariff classification” (CTC) approach is considered co-equal to a regional value content (RVC) test. For most goods, exporters have the choice of testing their products under a CTC-based rule or an equivalent RVC-based rule. For work on ROOs, the extension of the co-equal approach could bring considerable benefit to CEPEA. The work on ROOs could also look at harmonising the different product specific rules in the FTAs, and the undertaking of sectoral studies for streamlining and rationalising ROOs to facilitate regional production networks, and to respond to the dynamic changes in regional production processes.

ROO is also an area where CEPEA could build on existing work underway on a regional level. As part of the AANZFTA Economic Cooperation Work Program, a component on ROO has been agreed to facilitate effective utilization of commitments through efficient and transparent administration of ROO. Among the activities foreseen are the development of procedures to ensure the smooth implementation of the ROO and the development of procedures to facilitate the use and authenticity of Certificates of Origin.

3. Product Standards

Product standards and the adoption by governments participating in regional arrangements of measures to avoid differing standards becoming barriers to trade are important regional integration issues that should not be ignored in the CEPEA context. The experience of the European Communities is very instructive in respect of standards and it would be altogether natural for CEPEA countries to work to facilitate trade through a standards-related program.

Another important reason to consider CEPEA-wide activity on standards is that this seems to be an area where ASEAN countries’ work is fairly new and where other members of the CEPEA region might be able to assist ASEAN governments through sharing their experiences with standards questions in other agreements. Previous ASEAN instruments did not deal effectively with standards-related issues, but the new ASEAN Trade in Goods Agreement (ATIGA) does have important standards-related provisions.

Additional Input- Facilitation Opportunities in CEPEA (Australia, New Zealand, Malaysia)

In respect of product standards, it may be appropriate for CEPEA to build-on the sectoral MRAs of the ASEAN Framework Agreement on MRAs and other MRAs that may be identified in ASEAN's work programme. In this connection a relevant cooperation area would be technical support and capacity building to the 'soft infrastructure' for conformity assessment and compliance.

Standards, technical regulations and conformity assessment procedures are also the subject of future work at the regional level under the AANZFTA Economic Cooperation Work Program. Among the indicative activities that feature in the agreed work program is the establishment of a program of support designed to:

- Enhance the transparent process of standards, technical regulations and conformity assessment procedures through information exchanges;
- Facilitate cooperation between the Parties in the areas of standards, technical regulations and conformity assessment procedures; and,
- Provide an analysis of the strengths and weaknesses of the regulatory and certification infrastructures of selected countries and identify areas for allocation of further resources.

Under the circumstances, and in the light of the imminent completion of the "ASEAN Plus One" process, Study Group members believe that it would be considerable scope for added value if CEPEA were used to build on existing efforts and launch a broader regional dialogue on standards and conformity assessment procedures.

4. Enhanced Customs cooperation and a CEPEA "single window"

It is clear that CEPEA could make a contribution to reducing obstacles to regional trade and reducing business transaction costs through customs facilitation activities. This is also an area where facilitation activities would benefit directly from the proposed cooperation on ICT questions. As has been noted in the Study Group, the measures outlined in the ASEAN Economic Community Blueprint on facilitation could provide a basis for facilitation cooperation in CEPEA. Areas for facilitation work at the CEPEA level could include:

- Implementing a trade facilitation programme aimed at harmonizing and standardizing trade and customs processes, procedures and related information flows;
- Implementation of ASEAN Cargo Processing model for customs procedures for imports; exports; warehousing; transshipment; and inward/outward processing
- Simplifying formalities for 'authorised traders' of good compliance. In this regard establish uniform and transparent criteria for designation of 'authorised traders'
- Cooperation in regional criteria and systems for risks management to facilitate flow of goods, and for supporting regional supply chain management of production networks in the region

Additional Input- Facilitation Opportunities in CEPEA (Australia, New Zealand, Malaysia)

- Adoption of standards and practices to secure a uniform system of tariff classification and a synchronized system of customs valuation; and,
- Build on the ASEAN single window initiative to establish an East Asian single window, that would help expedite customs clearance, reduce transaction time and cost and improve trade efficiency.

Regional cooperation on ICT questions and the implementation of AANZFTA's electronic commerce chapter should also make it possible for CEPEA to embrace the acceptance of electronic customs documentation and promote a paperless trading environment.

Input to CEPEA on Rules of Origin (India)

India

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Research and Information System for Developing Countries

Developing a Comprehensive View on Rules of Origin

1. Background

In recent times, countries have got engaged actively in regional economic integration processes at various levels of bilateral, sub-regional and regional cooperation, including in Asia. However, rules of origin have emerged as an area in which consensus is hard to achieve among countries, under any negotiations. Disagreements over rules of origin have often deferred the implementation of several trade agreements world-wide.

Much of such a phenomenon is attributable to a lack of sound understanding of the implications of rules of origin. It is thus imperative to develop a comprehensive view on the subject so as to prevent wastage of negotiating-time, to avoid cumbersome procedures and to implement the agreements with the intention to reap the economic benefits of such endeavors as fast as possible in under a comprehensive initiative such as the EAS. To this end, the CEPEA could play a decisive role.

2. The Rationale

It is obvious that a country would like to allow goods from a partner country on a preferential duty basis under a trade agreement provided the goods have originated in the partner country. However, there is always a possibility that third-country goods enter a country's markets through the partner country and that too, on a preferential basis. This phenomenon is well known as 'trade deflection,' which has the potential to undermine a country's MFN-customs regime. Thus, one of the prime objectives of rules of origin is to check trade deflection. It is also important to bear in mind that rules of origin are not to safeguard against imports *per se* instead they are to check deflected imports from third countries.

Rules of origin influence both our import patterns and export prospects. If they are too stringent they may provide import protection but also scuttle export prospects and if they are too liberal the converse may be true. Thus, a combination of different modalities can give the policy space to balance the objectives of export promotion and efficient imports actually originating from the partner countries.

3. Modalities

Global practices have mostly combined the modality of change in tariff classification with local value addition norm, specific process test, regional cumulation and non-qualifying operations. However, the exact mechanisms differ in NAFTA, agreements between the EC and its partners, MERCOSUR, and FTAs of Japan-Singapore, Australia-Thailand, and Singapore-USA, ASEAN among others.

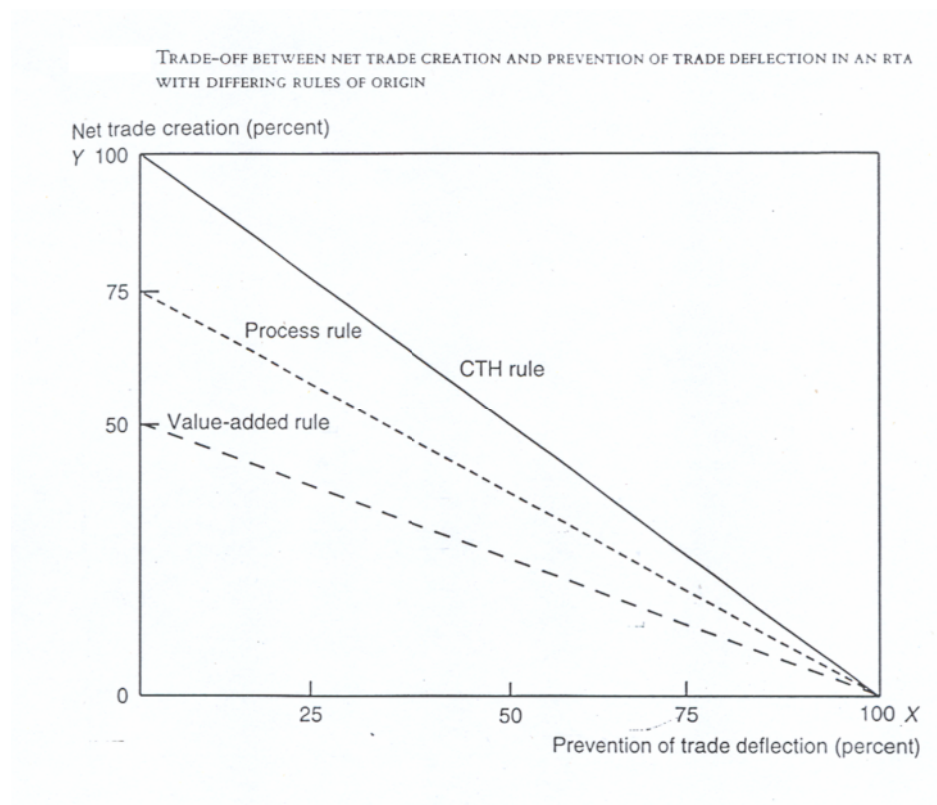
There are different methods of determining originating status of products. Whether or not a product has originated in a particular country is decided if the product has undergone substantial transformation. In other words, the final product should be distinct from its constituents. Three kinds of tests are applied to determine this. First, the change in tariff heading test whereby the tariff heading of the final product is different from the tariff headings of its components. Second is the percentage test according to which a minimum percentage of total value addition should be achieved with the help of indigenous inputs. And third, specified process tests that require a product to undergo certain stipulated processes.

However, agreement on implementing these tests is often difficult. For instance, the extent of 'substantial transformation' for different products would depend on the level of disaggregation of Harmonised System (HS) (i.e. HS 4- or 6-digit level) on which tariff-shift is envisaged. Similarly, fixing of percentages of minimum value addition varies between products, depending on the prevailing labour costs and the product-specific import dependence of the country in terms of intermediates.

In terms of the specifics, a combination of change in tariff heading (CTH) at HS 4-digit level and local content norm of 40 percent is neither too stringent to be akin to non-tariff barrier nor too liberal to open the floodgates for trade deflection. This is because on the spectrum of HS nomenclature of tariffs a movement towards a change in tariff classification at 2-digit chapter level (CC) would be too stringent and conversely, a change in tariff at 6-digit sub-heading level (CTSH) would be too liberal.

Transformation of inputs into output at HS 4-digit level (CTH) thus provides the middle level balance inasmuch as it can check trade deflection and help achieving developmental objectives through enforcing manufacturing without becoming a stringent non-tariff barrier. By the same token, 40 percent stipulation of local content is neither too stringent to scuttle the prospects of imported inputs used in manufacturing nor too liberal to pave ways for third-country imports coming into any country on a preferential basis without undergoing adequate manufacturing process. A major advantage of combining CTH with 40 percent local content norm is that when used in conjunction they counter the demerits of each modality applied in isolation. In addition, there is always a scope to build product-specific derogations from such general rules.

Figure 1



Source: Stephenson, S. M. and James, W. E. (1995), "Rules of Origin and the Asia-Pacific Economic Cooperation" *Journal of World Trade*, Vol. 29, No. 2, April, pp. 77-103

A comprehensive approach towards rules of origin issues can therefore help solve several problems of RTA negotiations in which Asian countries are presently engaged. Such an approach has yielded straightening of negotiating positions on several occasions in the past including India-Sri Lanka FTA, India-Thailand FTA for the Early Harvest Programme and India-Singapore CECA and even India-ASEAN, to name a few in which India has participated. Such instances as also experiences of other countries in the region would have favourable impact on the EAS process through the CEPEA deliberations.

As it was mentioned, the twin criteria of rules of origin (change in tariff classification and value-addition percentage requirement) help to offset the well-known demerits of each of the two criteria. In this regard, it may be further highlighted that the change in tariff classification criterion has been found to be the most effective in checking trade deflection while trade creation takes place (Figure 1).

4. CTH vs. CTSH

In the context of discussions over the level of disaggregation at which CTC could be most efficaciously applied, it is pertinent to highlight some of the merits of CTH in comparison to the CTSH criterion.

Firstly, the CTH rule can enforce bilateral cumulation within a bilateral FTA and enhance bilateral trade. On the other hand, in the case of CTSH application such possibilities would be limited. As an illustration, if a partner country fulfils maximum of its raw material requirements through imports and technically the final product qualifies for a CTSH rule, then by stipulating a CTH rule would imply that the partner country necessarily imports its material from the co-partner and qualifies for preference under the bilateral cumulation provision.

Second, the CTH rule could also ensure in the partner country the usage of a particular kind of manufacturing-technology in a manner that the raw materials have to be necessarily sourced from other HS-4 digit level classifications.

Third, the application of the CTH rule also ensures certain minimum amount of local value addition in that country. Not all manufacturers in other countries produce the final product from basic raw material since different manufacturers are at different stages of production. Thus, CTH can ensure local value addition for granting originating status to products and extending tariff preferences. In case of CTSH such value addition possibilities might be compromised. It may be mentioned, that in case only the percentage test is applied accuracy of value addition is not guaranteed because of likelihood of accounting manipulations.

Accordingly, CTH safeguards national economic interests given the state of technology in different sectors of our country. Thus, the CTSH rule should be applied only in cases where there is a technical impossibility to apply and adhere to a CTH rule.

5. Rules of Origin as a Development Policy Tool

It may be highlighted that it is not true that rules of origin would be redundant once a country, which is a member of different trade agreements, reduces its MFN-tariffs considerably to very low levels. In fact, there is evidence to suggest that stringent rules of origin and liberal tariff regimes are inversely related. The natural question arises as to why be that so?

The answer possibly lies in the fact that rules of origin are not just trade policy instruments aimed at preventing trade deflection. They are used as a developmental tool. Firstly, these rules, executed through different modalities like change in tariff classification, value-addition norms, specific process tests and non-qualifying operations, enforce domestic manufacturing that is in essence substantial in nature. The three modalities of determining origin of a product aim at substantial

transformation in inputs. Thus, rules of origin together, facilitate value-addition in the country of manufacturing. Such requirements, checking the import content of value addition, have the potential for generating backward and forward linkages in a country adhering to the rules. Thus, a member country is prevented from becoming a mere trading country as these requirements act as a deterrent to assembly kind of production activities. The rules of origin thus, have important implications for the development of the manufacturing sector as a whole, which in turn, contributes towards enhancing the export supply capabilities of the member country.

Second, it provides an impetus to the necessary commensurate supportive services sector activities. It can be argued that manufacturing activities brought about with the help of rules of origin stipulations in order to export the final product under a preferential trade agreement cannot be possibly executed without the existence of a supportive services sector. For instance, trade in goods is incumbent upon the presence of facilitative services like post-shipment credit, consignment-insurance, bank-guarantees, shipping services etc. that not only facilitate trade but also contribute to the competitiveness of exports.

Third, rules of origin have been used as instruments to promote investment to boost regional production, especially in NAFTA. It has been highlighted by Rugman (Rugman M. Alan, *“The Rules for Foreign Investment in NAFTA”*, Latin American Business Review, Vol. 1 (1) 1998, pp. 77-94) as to how rules of origin have been used in NAFTA to attract foreign investment for talking advantage of the regional market in NAFTA by the non-member countries.

Fourth, through regional/bilateral cumulation provisions of origin-rules regional/bilateral trade flows can be augmented. All these positive effects on manufacturing (and on agriculture, through agriculture-industry linkages), services and investment have important implications for employment and income generation, foreign exchange earnings and regional integration. In nutshell, rules of origin, if used in a comprehensive manner can help achieve developmental objectives. It is in this sense that they can become a developmental tool and have the potential to strengthen trade-development linkages under RTAs/FTAs.

Enhancing the Feasibility of Welfare-inducing FTA

Incorporating intermediate inputs into a small-union general-equilibrium model, Duttagupta and Panagariya (Duttagupta, Rupa and Panagariya, Arvind, (2003) “Free Trade Areas and Rules of Origin: Economics and Politics” IMF Working Paper, WP/03/229) develop the welfare economics of preferential trading under the rules of origin demonstrating that a welfare reducing FTA that was rejected in the absence of the ROO becomes feasible in the presence of these rules. Second, a welfare improving FTA that was rejected in the absence of the ROO is endorsed in their presence, but upon endorsement it becomes welfare inferior relative to the status quo. This could happen because ‘the ROO increases the price of the regionally produced intermediate input and hence effectively provides protection to it. The FTA that was unattractive to the input exporter in the absence of a ROO can now become attractive. Therefore, the ROO could make a previously infeasible FTA feasible.’ One may argue that a combination of different origin-rules contributes to such an effect.

Hence, rules of origin do not lose their significance if tariff levels are reduced. What is more, rules of origin are important also in the context of imposition of anti-dumping duties and countervailing duties. Without them it is difficult to collect even trade statistics. It is not without reason that even for non-preferential trade flows rules of origin are important and there is a WTO Agreement on Rules of Origin.

6. The Implementation

However, the comprehensive treatment of the subject should not lose sight of the fact that rules of origin at times can be used as non-tariff barriers and this needs to be discouraged. In addition, adequate care must be taken to ensure that rules of origin are implemented in a manner that minimizes the scope for its misuse and malpractices. Efforts geared towards minimization of cost of compliance through procedural simplifications also warrant priority-attention. All these together would truly make rules of origin a set of instruments to achieve developmental goals through strengthening trade-investment-development linkages.

Due to the complexities involved in the implementation of Product-specific Rules of Origin (PSRs), especially in the wake of the fact that PSRs have been or are being worked out in several FTAs in Asia and its efficacy would only be improved by tackling the implementation issues.

With increasing production networks in Asia, various types of cumulation would also be needed to be studied in detail.

7. Summing Up

In the end, it is worth reiterating that rules of origin, if devised and understood adequately, could serve as a development policy tool within the ambit of a regional economic cooperation agreement in EAS. It can contribute to trade and investment expansion and through its emphasis on value addition; it has rich potential for employment and income generation.

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Government procurement, IP and
CP (Malaysia, New Zealand)

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Facilitation: Government procurement, IP and CP

Three areas of facilitation which can be potentially contentious are provisions relating to:

- Government procurement;
- Intellectual property; and
- Competition policy.

These aspects can be contentious because they are seen by some government's, particularly those in developing economies, as running counter to their industrial and economic development objectives.

1. Government procurement

Central and local authorities account for a large proportion of economic activity in most economies and are a major demander (and supplier) of goods and services. In East Asia, government procurement typically accounts for around 15-20% of GDP in developed countries, and 8-12% in developing countries.¹ It follows that there are significant gains to be made from ensuring that government purchases of goods and services in East Asia are directed as efficiently as possible.

¹ OECD, *The Size of Government Procurement Markets*, (Paris: OECD, 2002).

As with private expenditure, government procurement can benefit from increased competition, including from foreign providers. The openness of government procurement sectors varies widely in East Asia.²

It is important to recognise the unique nature of some aspects of government procurement that may preclude it from being fully opened up to competition and the sovereign rights of governments to design domestic regulations accordingly. That said, encompassing government procurement under a CEPEA should not be about exposing domestic suppliers unfairly or ‘selling off the family silver’. Rather, it is about ensuring that such regulations do not – as much as is practicable – unduly discriminate against foreign providers.

Government procurement provisions are often viewed through a defensive negotiating lens – negotiators are often concerned with protecting domestic participants in supply chains. It is important to balance this view by considering:

- The potential benefits that could accrue to domestic suppliers who *are* internationally competitive from greater entrance opportunities in overseas government procurement markets; and
- The potential productivity gains to domestic providers: Opening up some parts of government procurement supply chains to international competition will make inputs into these sectors cheaper and/or of superior quality so that more output can be delivered for the same cost. These productivity gains will lead to improved development and social outcomes.

The Study Group recognises the sensitivity of access conditions to government procurement markets for developing economies, but considers that this matter should remain open for discussion between CEPEA parties. The potential gains from improvements in a significant sector should not be completely overlooked and the greater the opportunities for trade-offs among the parties the more likely a successful and dynamic agreement will be achieved.

2. Intellectual Property and Competition Policy

An increasingly important aspect of modern, comprehensive preferential trade agreements relates to ensuring that domestic regulations on competition policy (CP) and intellectual property (IP) reinforce rather than retard the flows of benefits that stem from goods and services

² Of the 53 countries covered, the IMD Competitiveness Yearbook (2006) ranks Australia, New Zealand and Singapore as having the most open government procurement regimes amongst the countries covered by the East Asia Summit. Some larger East Asian economies such as Korea, China and Japan are considered to be less open to foreign competition. South-East Asian economies such as Thailand, India and Malaysia are generally ranked somewhere in the middle of these two groups.

trade liberalisation. This is because it is broadly agreed that open, competitive markets are better placed to deliver the positive welfare gains from trade liberalisation.

There has been to date some nervousness amongst some East Asian countries about making firm or deep commitments on CP and IP in their trade agreements. This may in part reflect the view that new or more sophisticated regulatory frameworks are sometimes required in order to ensure that liberalisation delivers the expected benefits.³ However, the degree of commitment required on these two issues is something that should be discussed in preparations for a CEPEA negotiation. As with government procurement, there is no suggestion here that provisions under a CEPEA should undermine the right of members to implement sensible and equitable domestic regulations on competition and IP, taking into account their legal and administrative systems, as well as economic policies and circumstances. However, processes such as dialogue between national experts, information-sharing and cooperation and capacity building, at the very minimum, should be put in place under a CEPEA to work towards building understanding of members' policy settings and how they might impact upon other members. The crucial point is that it is important to seek to ensure that the benefits of trade liberalisation in East Asia are not undermined by anti-competitive practices and reluctance to trade or invest due to lack of protection for IP.

³ OECD, *The Contribution of Services to Development and the Role of Trade Liberalisation and Regulation*, Paper presented to the Global forum on International Investment, March 2008, p.3.

Potential Benefits of the
Liberalization of Labour Movement
(Australia)

Australia

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Potential Benefits of the Liberalisation of Labour Movement

There is a growing consensus amongst world economists that liberalising the supply of a service through the temporary movement of natural persons could generate very large mutual gains to both developing and developed countries. It is estimated that an increase in developed countries' quotas on the inward movements of both skilled and unskilled temporary workers equivalent to 3% of their workforces would generate an estimated increase in global welfare of about \$US 156 billion.

Despite the potentially huge gains from liberalising mode 4 and the commonality of interest between developing and developed countries little has so far been achieved within the framework of the GATS. There is however a significant opportunity in a region-wide CEPEA for the mutual benefits of increased temporary movement of labour to be realised. An increasing number of FTAs between countries in the region are recognising this with gradual undertakings for increased labour market access for specific groups of professionals, businesspeople and tradesmen.

Perhaps a less known fact is that virtually all studies on the temporary movement of natural persons show that the greatest absolute and poverty-related gains for developing countries come from the liberalization of the low and unskilled¹. Greater liberalization of mode 4 would allow developing countries to exploit their relative abundance of low and unskilled labour and to better address development gaps within and between economies. Mode 4 service providers would benefit directly from higher real wages, some of which would flow back to the sending country in the form of remittances.

Nevertheless there are significant immigration, social and at for some, political challenges that need to be considered before a region-wide agreement might be tailored to best facilitate the mutually beneficial flow of higher and lower skilled persons. CEPEA could undertake modest steps in the consideration of such an agreement by initiating more detailed research on the potential benefits and challenges of the liberalisation of both higher and lower skilled workers in the East Asian region.

¹ See Winters (2002), Walmsley and Winters (2003) and Walmsley, Winters, Parsons and Ahmed (2005).

Analysis of Existing Intra-East Asia
Summit Commitments Involving
ASEAN (New Zealand)

New Zealand

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Analysis of existing Intra-East Asia Summit commitments involving ASEAN

1. Preface

NZIER is a specialist consulting firm that uses applied economic research and analysis to provide a wide range of strategic advice to clients in the public and private sectors, throughout New Zealand and Australia, and further afield.

NZIER is also known for its long-established Quarterly Survey of Business Opinion and Quarterly Predictions.

Our aim is to be the premier centre of applied economic research in New Zealand. We pride ourselves on our reputation for independence and delivering quality analysis in the right form, and at the right time, for our clients. We ensure quality through teamwork on individual projects, critical review at internal seminars, and by peer review at various stages through a project by a senior staff member otherwise not involved in the project.

NZIER was established in 1958.

2. Authorship

This report has been prepared at NZIER by Claire Gall and James Zuccollo and reviewed by Brent Layton and John Ballingall.

3. Acknowledgements

Ms Anna M. Robeniol and Mr Salvador M Buban of the ASEAN Secretariat in Jakarta very kindly provided access to the schedules to the trade agreements which have been analysed in this report. James Allen of the New Zealand Ministry of Foreign Affairs and Trade kindly provided the COMTRADE data.

4. Key points

- Numerous trade agreements already exist in the East Asia Summit region. These agreements – and those under negotiation or being studied – provide for significant reductions in tariffs on trade within the region over the next 15 years.
- Our report examines empirically the current and future coverage of existing ASEAN-EAS agreements in terms of tariff lines and value of trade.
- It demonstrates that for a number of countries a very high proportion of ASEAN-EAS trade will be subject to tariffs of between 0% and 5% by 2025.
- This suggests that much of the domestic industry adjustment to a lower tariff regime in the region will take place in coming years as a result of existing commitments.
- Moving to a broader regional trading agreement such as CEPEA, therefore, may not represent a huge hurdle for many economies, and would reduce the amount of existing trade diversion and current distortions between CEPEA members.
- Our research also highlights the variability in the quality and quantity of information available to analysts and policy makers on trade agreements and trade values. Where this data is missing or inconsistent, it prevents evidence-based discussion. This is particularly prevalent for the less developed countries in our report. Improving these data sources should therefore be a priority area for future research or cooperation activities.

1. Introduction

This report measures the progress of trade negotiations in the East Asia Summit (EAS) region by performing an analysis of the current Intra-EAS commitments involving ASEAN. Our results quantify the extent to which the current commitments made by ASEAN with other EAS countries will move the region towards a low tariff trade environment.

The results of this analysis give an indication of how well integrated East Asian economies are and how much additional adjustment might be required to move to broader liberalisation under a Comprehensive Economic Partnership for East Asia (CEPEA).

2. Measurements

In this study we provide measures of the extent of the tariff commitments made in the trade agreements signed by ASEAN to date. To do that we calculate four measures of trade liberalisation for each of the parties to each of the ASEAN trade agreements. The measures we use are:

- The percentage of national tariff lines which in selected years will have a tariff rate of zero percent.
- The percentage of national tariff lines which in selected years will have a tariff rate of between zero and five percent.
- The percentage of base year trade with parties to the trade agreement which in selected years will be subject to a tariff of zero percent.
- The percentage of base year trade with parties to the trade agreement which in selected years will be subject to a tariff of between zero and five percent.

The analysis of both the number of tariff lines at 0-5% and the amount of trade flowing across these lines is important in considering whether the agreement meets the WTO definition of an FTA covering ‘substantially all trade’.

For each trade agreement which has entered into force between ASEAN and other members of EAS we calculate each of these measures for each of the parties. In order to measure progress towards lower tariff barriers we have repeated the calculation for a number of years between the base year – generally 2005 - and the final year in our analysis. For some agreements the final year is 2025 and for others it is 2026. This allows us to get a sense of how liberalised East Asian trade

Additional Input- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)

is now (a static approach) and how the situation will change to become progressively more liberal over the next fifteen years (a dynamic approach).

3. Scope

3.1 The Agreements

The agreements included in our study are those between:

- ASEAN, Australia and New Zealand (AANZFTA)
- ASEAN and Japan (AJCEP)
- ASEAN and China (ACFTA)
- ASEAN and Korea (AKFTA)

The text of the ASEAN-India agreement was not available to us since the agreement has not yet been signed.

3.2 Time frame

We selected four time periods in which to measure the level of commitment. Those years are the base year (2005), 2011, 2017 and 2025/26. The final year was chosen to be 2025 to account for the final commitment period in all agreements studied. However, since AJCEP's commitment period ends in 2026, that year is used for AJCEP.

The period over which commitments for each agreement take effect is not the same across agreements. For example, the AKFTA commitments are fully implemented by 2016. Consequently, the liberalisation measures we calculate for 2017 and 2025 are identical, but that does not indicate a lack of progress by the parties, merely a shorter period over which commitments will be introduced. Indeed, the 'front-loading' of commitments is a positive outcome, as it brings forward the benefits of liberalisation. The data must be interpreted with this in mind.

3.3 Data sources

We used data from three sources: Data from the WTO and ASEAN secretariat for the base year's MFN tariff rates applied by the nations; data from the ASEAN secretariat for the tariff rates

Additional Input- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)

applicable under each agreement; and, data from the United Nations' COMTRADE database for the value of trade between the parties in the base year.

The base year that we chose for our study is 2005. Unfortunately, data on imports into Cambodia, Brunei, Laos and Myanmar was not available for 2005. Instead, we used data from 2004 for Cambodia and from 2006 for Brunei. Numbers for Laos and Myanmar were not available for years more recent than 1974 and 1992 respectively. We chose to omit import data from those countries, so measures of the percentage of tariff free trade into those nations are not presented.

The quality of data on tariff schedules varied between the agreements. The AANZFTA agreement contained details of the tariff schedule for each country broken down by Harmonised Standard (HS) code and year in spreadsheet form. That allowed us to be precise about the tariff commitments in each of the years we studied. By contrast, only the annexes of the ACFTA agreement were available.

The data available for the other agreements contained a mix of detailed spreadsheets and annex commitments. Consequently we were unable to produce reliable figures for all nations across all agreements. The gaps in our results are a product of that limitation. Improving the quantity and quality of trade agreement data that is available to researchers in the future will allow more systematic and robust analysis, and this may represent a valuable use of economic cooperation resources.

Appendix A provides more detail on the quality of the data available for each agreement.

4. Scope

The results of our analysis are presented in three ways. Below we give charts of aggregated numbers as an overview of the data. We also attach a spreadsheet of our disaggregated results, and a Pivot Chart as described in section 4.2.3.

4.1 Tariff lines

In the following figures we present a comparison of each country's commitments over time under each agreement. Each line represents a country's commitments made for a single agreement. It shows the percentage of total tariff lines that the country has committed to maintaining at a tariff rate of 5% or less under each agreement.

The figures show the percentage of tariff lines which attract a low tariff if imported into the named country from another party to the named agreement. For example the AJCEP plot for Indonesia

Additional Input- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)

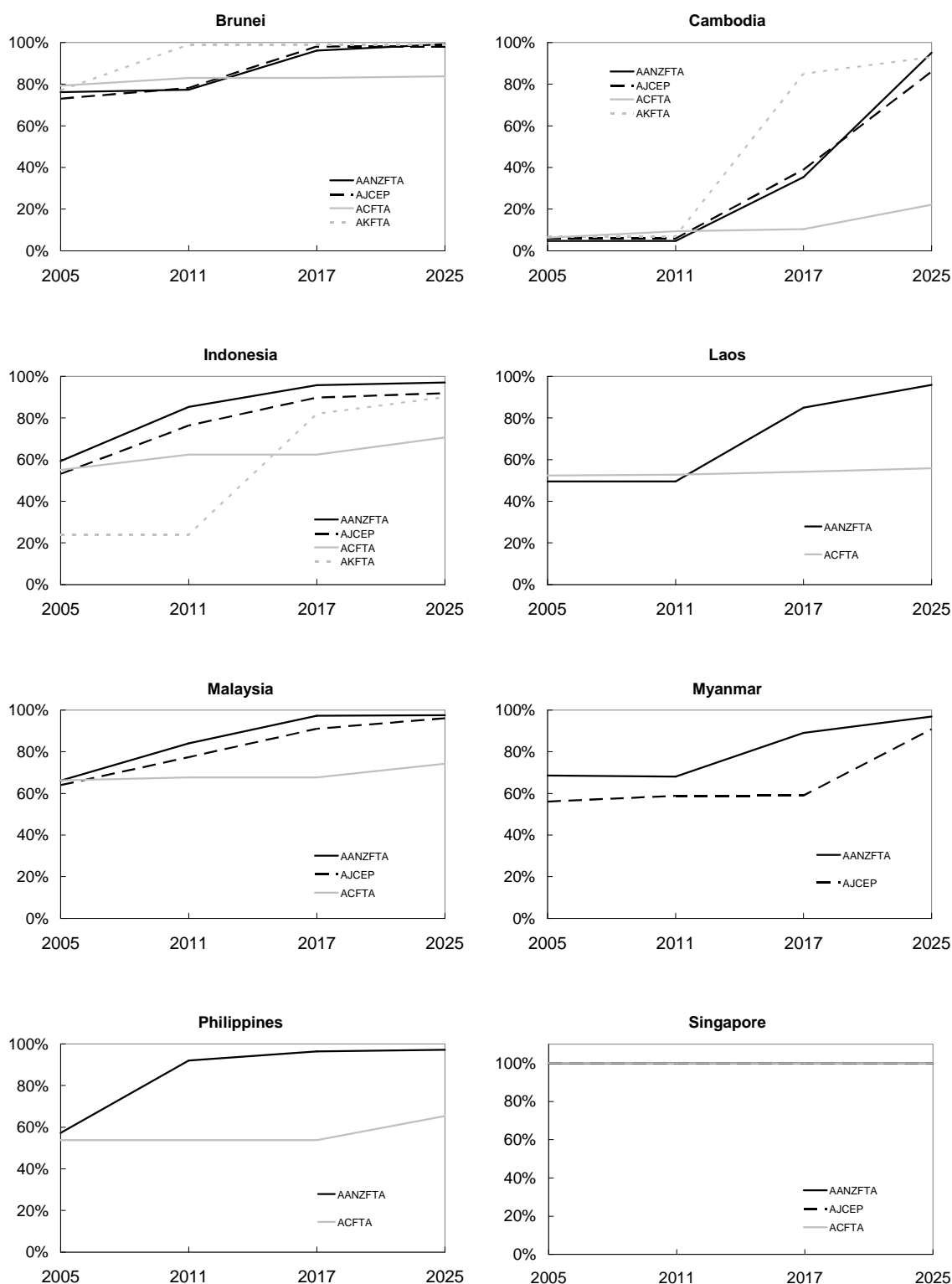
shows the percentage of tariff lines on imports into Indonesia, from parties to the AJCEP agreement, which will be eligible for a tariff rate of 5% or less.

The figures count MFN rates which are at, or below, 5% but do not account for any other trade agreements that the country may be party to.

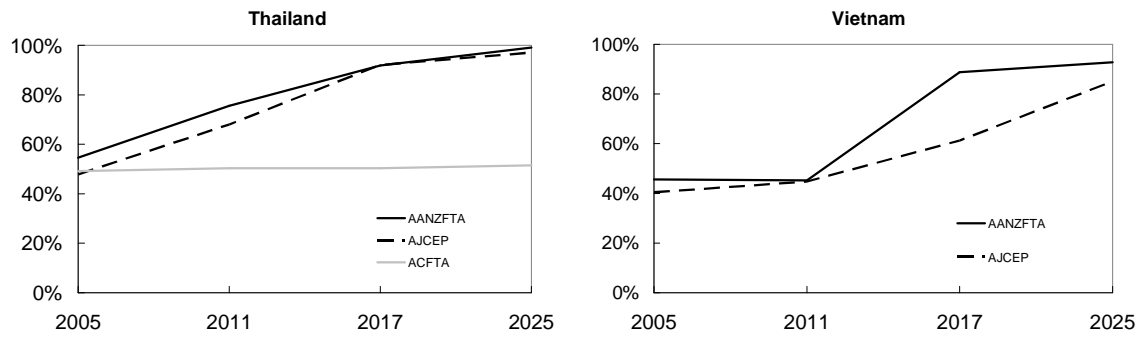
4.1.1 ASEAN nations

Figure 1 Percentage of tariff commitments in 0-5% range – ASEAN nations

Percentage of total import tariff lines that will be reduced to the 0-5% range in each period



Additional Input- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)

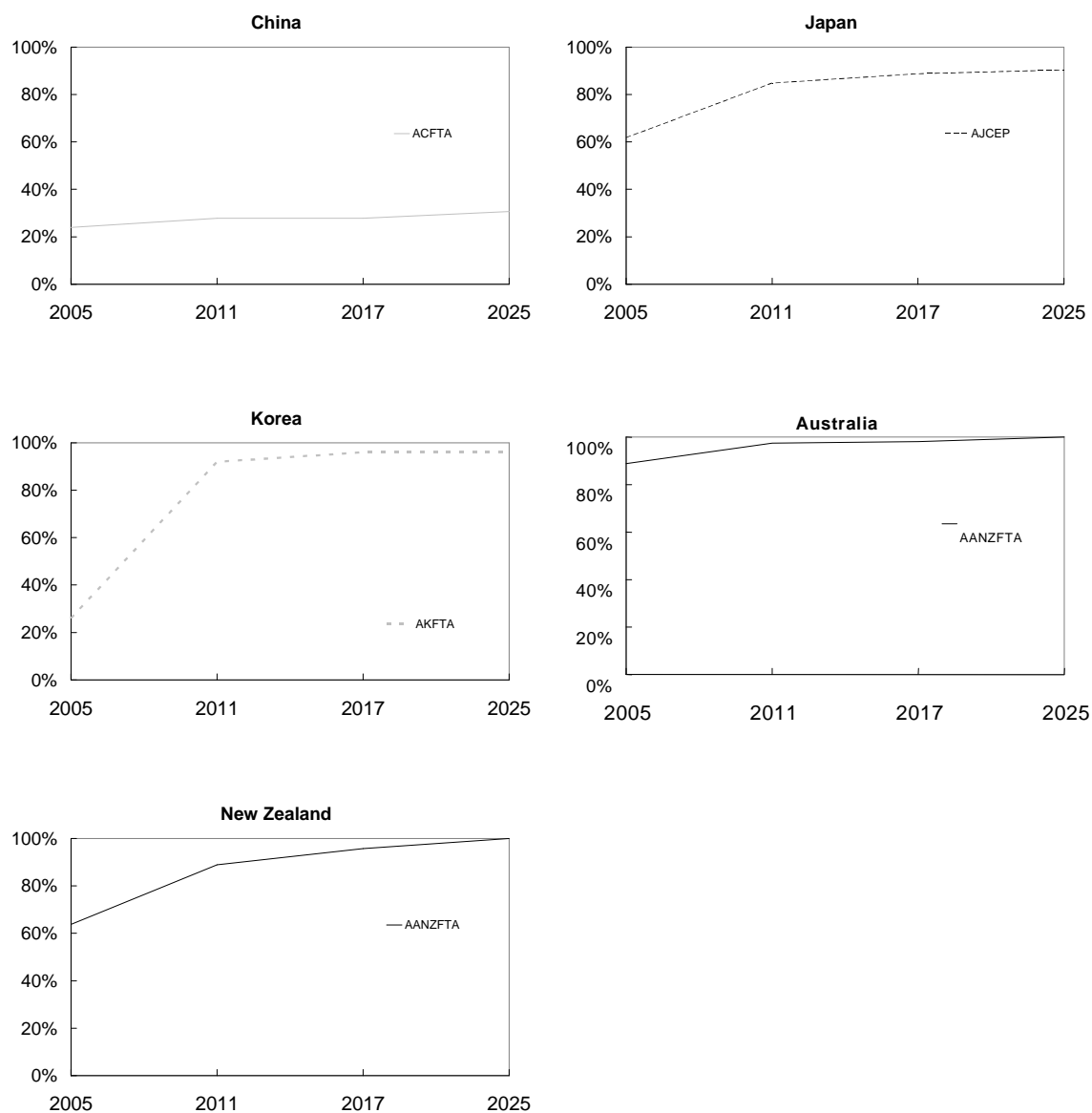


Source: NZIER

4.1.2 Partner nations

Figure 2 Percentage of tariff commitments in 0-5% range – partner nations

Percentage of total import tariff lines that will be reduced to the 0-5% range in each period



Source: NZIER

4.2 Value of Trade

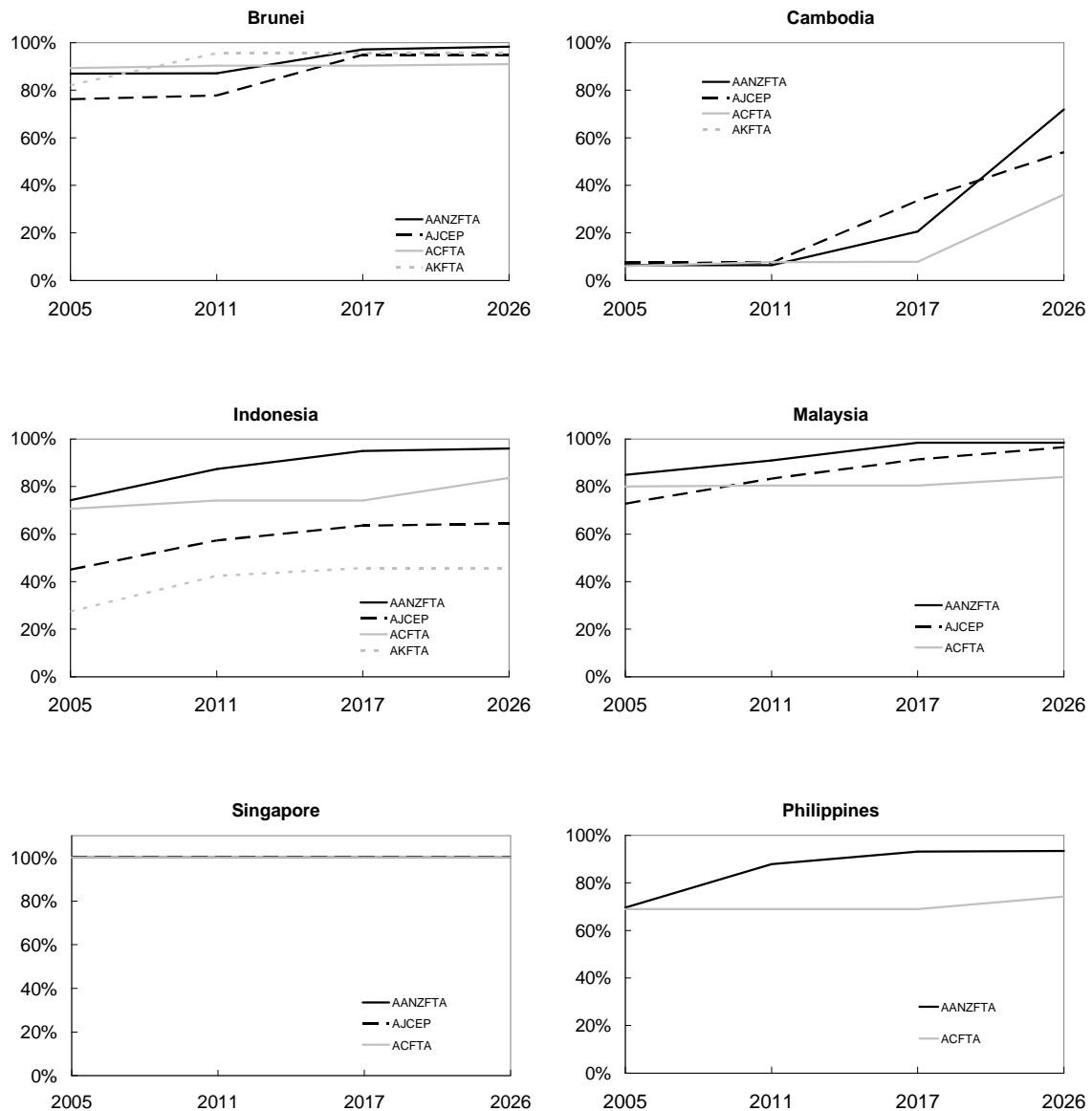
The figures in this section show the percentage of base year imports into each nation, by value, which will be eligible for tariffs of 5% or less under each agreement.

Using the example of Indonesian imports again, the figure for Indonesia shows four lines corresponding to the agreements to which Indonesia is a party. For each agreement, the line shows the percentage of Indonesia's imports in 2005 originating from other parties to the agreement which will be eligible for a tariff of 5% or less under that agreement.

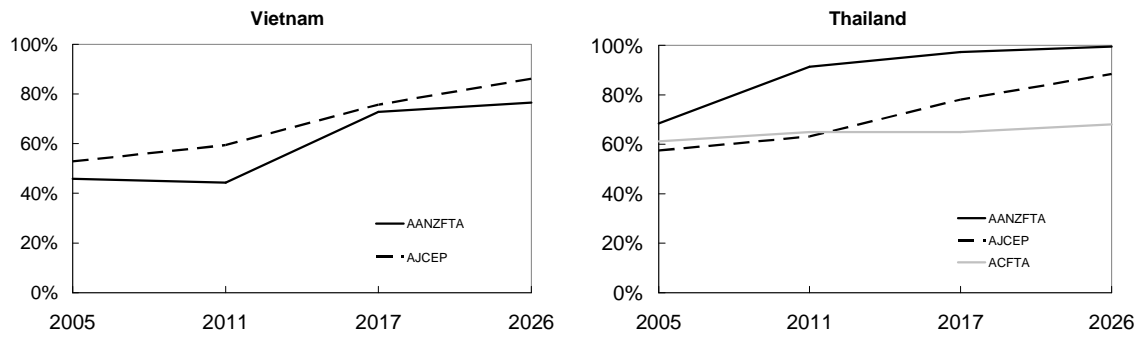
Like the previous figures, this series shows variation over time. To examine variation across nations see the Pivot Chart described in section 4.2.3.

4.2.1 ASEAN nations

Figure 3 Percentage of 2005 imports (by value) with tariffs in the 0-5% range – ASEAN nations



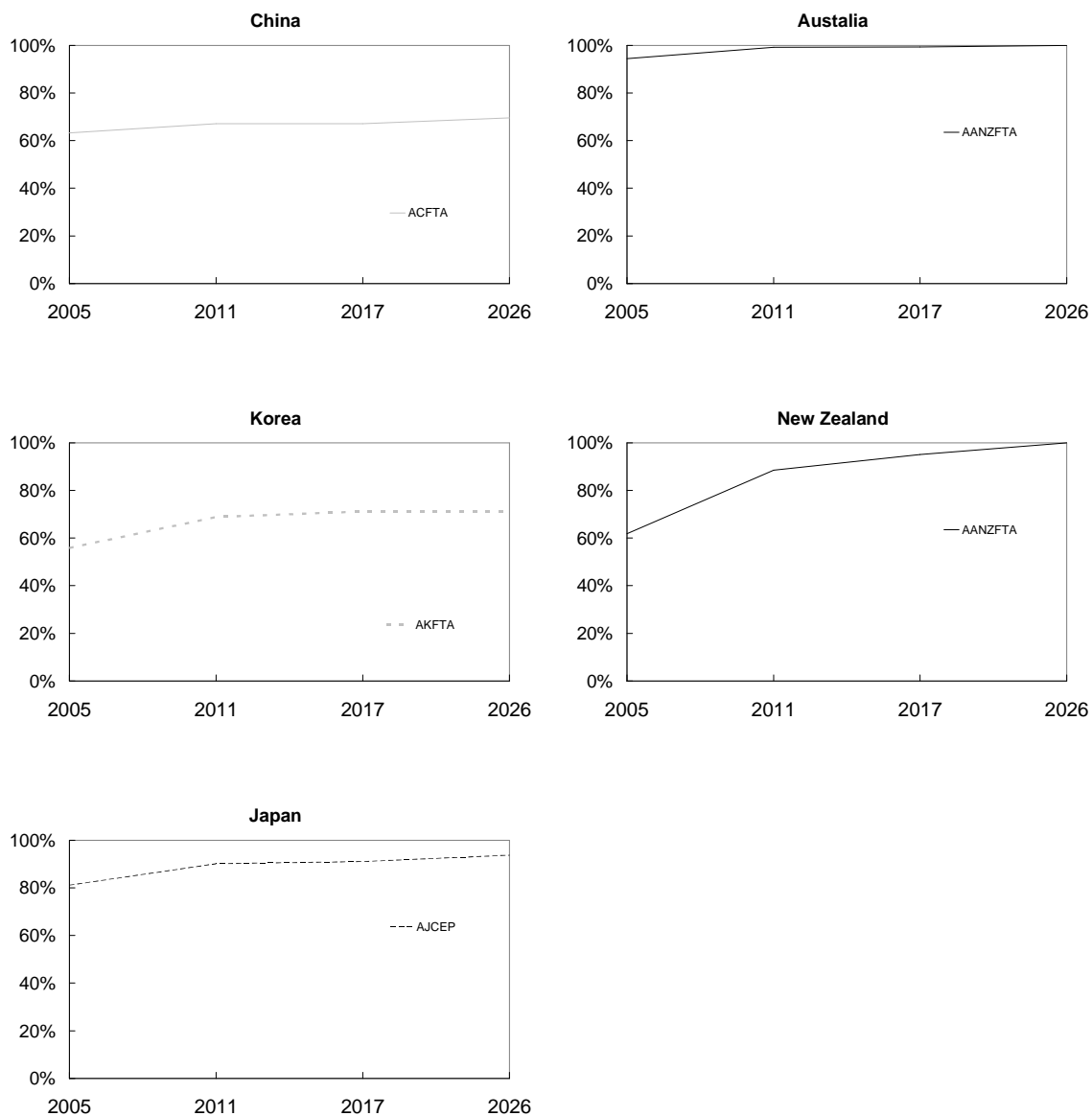
Additional Input- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)



Source: NZIER

4.2.2 Partner nations

Figure 4 Percentage of 2005 imports (by value) with tariffs in the 0-5% range – partner nations



Source: NZIER

4.2.3 Alternative data presentation

For those who wish to explore these results further we have appended an Excel spreadsheet which includes a Pivot Chart and Pivot Table. These tools allow the viewer to display the four-dimensional data (year, importer, exporter, agreement) presented here in their preferred fashion. Using the Pivot Chart allows easy comparisons between nations and the relevant information can be easily explored and distilled. An online guide to Pivot Charts is available at <http://peltiertech.com/Excel/Pivots/pivotstart.htm>.

5. Summary

The results show a significant and systematic difference in the coverage of the trade agreements. The AANZFTA agreement is consistently the most extensive in its coverage of both tariff lines and trade value. At the other end of the scale, the ACFTA agreement is consistently the least comprehensive in its tariff reduction commitments. AKFTA is the next least comprehensive.

Our report demonstrates that for a number of countries the East Asia Summit region a very high proportion of ASEAN-EAS trade will be subject to tariffs of between 0% and 5% by 2025. This suggests that much of the domestic industry adjustment to a lower tariff regime in the region will take place in coming years as a result of existing commitments. Moving to a broader regional trading agreement such as CEPEA, therefore, would not represent a huge hurdle for many economies, and would reduce the amount of existing trade diversion and current distortions between CEPEA members.

Our research also highlights the variability in the quality and quantity of information available to analysts and policy makers on trade agreements and trade values. Where this data is missing or inconsistent, it prevents evidence-based discussion. This is particularly prevalent for the less developed countries in our report. Improving these data sources should therefore be a priority area for future research and a focus for cooperation activities under CEPEA.

Appendix A Data availability

A.1 General

Three types of data were needed for our calculations: schedules showing the agreed tariff reductions, data on the MFN tariff rates for each nation and import data showing the value of trade between the parties to the agreements. The availability of MFN rates and import data is shown in Table 1.

Table 1 Data availability

Indicates the type of data available for each purpose

	MFN tariffs and year	Import data for 2005
Australia	For 2007	Yes
Brunei Darussalam	For 2007	For 2006
Cambodia	For 2008	For 2004
China	For 2006	Yes
Indonesia	For 2006	Yes
Japan	For 2005	Yes
Korea	For 2008	Yes
Laos	For 2008	No
Malaysia	For 2001	Yes
Myanmar	For 2002	No
New Zealand	For 2006	Yes
Philippines	For 2007	Yes
Singapore	For 2006	Yes
Thailand	For 2007	Yes
Vietnam	For 2008	Yes

Source: NZIER

Most Favoured Nation (MFN) data from the WTO is provided at the Harmonised Standard (HS) 6 digit level. It gives the number of tariff lines encompassed by the HS6 code, the average rate of those ad valorem (i.e. value based) tariffs, and the number of lines under that HS6 code which are zero. Most of the problems occurred when attempting to match tariff schedules at an 8 or 10 digit level, to the MFN data. Where there was a large divergence between the number of lines in the tariff schedule and the reported number of tariff lines in the MFN schedule we chose not to proceed with the analysis

A.2 AJCEP

Information on this agreement was provided as a mix of spreadsheets and Word documents. It proved possible to extract tariff schedules from the Word documents. Unfortunately, the Philippines schedule did not match with the MFN table sufficiently and we were forced to discard it. The Vietnamese schedule was also a poor match but we deem it sufficiently good that the results are not misleading. The data for Laos was not sufficient to complete any calculations.

A.3 AANZFTA

The schedules provided by the ASEAN secretariat for the AANZFTA agreement included Excel spreadsheets detailing the tariff charged for each line in each year from the year of signing until the final year of commitment. All excluded lines were included in the schedules along with their tariff rates.

The completeness of these schedules allowed us to accurately calculate both the number of low tariff lines and the number of zero tariff lines in all periods.

A.4 ACFTA

This agreement's schedules were not available in the form of spreadsheets. We constructed spreadsheets using the annexes to the appendices, which list the tariff lines placed in each track. The WTO's records of countries' MFN tariff rates were used as the 2005 base year rate.

Since the tariff schedules constructed from the annexes did not perfectly match the WTO MFN tables, there may be some degree of inaccuracy in these numbers. Where the number of tariff lines was different between the agreement and the WTO's tables we adopted the WTO's numbers. However, the discrepancy was not large for the ACFTA agreement.

A.5 AKFTA

This agreement was the most problematic, as is evident from the limited number of countries for which we report results. The data provided was a mix of PDF, spreadsheet and Word documents.

Additional Input- Analysis of Existing Intra-East Asia Summit Commitments Involving ASEAN (New Zealand)

We were not able to extract data from the PDF schedules. Data for Laos, Thailand and Singapore was absent.

For many of the remaining countries the match between the MFN tables and the schedules was very poor. Cambodia and Indonesia's matches were marginally good enough for inclusion of the results. For the others omitted we were either unable to extract the data in the form provided or it was not a sufficiently good match with the MFN table to enable analysis.

A.6 Discrepancies

Some readers will note that the percentages of the MFN (Most Favoured Nation) lines which are low tariff varies across agreements when it would be expected to be constant. This occurs for two reasons. Firstly, different MFN rates were reported across a number of the schedules. In order to remain consistent within agreements we used the rates that the schedules to the agreements listed, if they were present. Because the schedules may have reported MFN rates from a different year to the WTO rates we otherwise used, some small difference is to be expected.

Secondly, the MFN tariff percentages differ is that some agreements did not allow for perfect matching of the tariff schedule data and WTO MFN data. Where this was not possible the number of MFN tariff lines may not match across agreements which also caused some differences to occur. Where the discrepancies seemed so large as to make our results implausible, we discarded the results.

Appendix B Methodology

B.1 Tariff line calculation

B.1.1 Percentage of zero tariffs

For the MFN rate this is the number of tariff lines with a rate of zero divided by the total number of tariff lines.

For future rates where the individual tariff lines' rates are not available, only the average rate at an HS6 digit level, we cannot simply sum the zero rates. Instead we summed the number of lines encompassed by average HS6 rates of zero and added the number of other lines with an MFN rate of zero.

B.1.2 Percentage of tariffs at 0-5%

This was calculated as the percentage of lines with an HS6-level average tariff of less than, or equal to, 5% plus the number of other lines with a rate of zero.

B.2 Value calculation

This calculation is similar to the calculation for tariff lines, only we took the value of imports corresponding to each tariff line in the range. Summing these values and dividing by the total value of imports from parties to the agreement gave the final percentages.

New Paradigm of Economic Growth:
Global Value Chain and Global
Production Network (Singapore)

Singapore

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New Paradigm of Economic Growth: Global Value Chain and Global Production Network

1. Introduction

In the past, economists would like to describe the path of development for an economy to follow the sequence, from an agriculture-based economy to one that is powered by industrial growth, and then to one that is service oriented. Not all developed economies follow that sequence, but generally, it is a pattern that is observed for many countries.

In recent years, that sequence of transformation is punctuated by many other developments because of new technological advancement made in information and communication technologies (ICT). For instance, the manufacturing of textile was often the pioneering industry for embarking on an industrialization process by developing economies in the 1950s and 1960s. However, this has changed significantly. Developing economies in the 1970s could skip textiles and move on quickly with light industries in the electronics related sector. The transition from one stage to another has sped up. Because of intense competition among developing economies for foreign direct investments to stimulate and promote growth, government of developing economies had made concerted effort to facilitate private entrepreneurs to secure contracts and businesses. At the international level, countries are participating in multilateral negotiations to remove barriers (tariff and non-tariff) to trade and capital flows. International agencies like the World Trade Organization (WTO) and International Monetary Fund (IMF) are bustling with multitude of fora, seminars and negotiations to nudge the world economy towards one that accommodates free trade in goods and services as well as capital and skilled labour.

Concurrently, the private sectors guided by market competition have been responsive to changing consumer demand and availability of inputs, be they natural resources or factors of production such as skilled technicians and research engineers, to devise new form of production arrangement to assure healthy bottom line and sustainability. In particular, we see the establishment of global commodity chain (GCC) or global value chain (GVC)¹ and global

¹ The concept of Commodity Chain is attributed to Gereffi, while the concept of Value Chain is pioneered by Porter. We have used the two concepts interchangeably in this paper.

production networks (GPN). These GVCs and GPNs become new 'port of entries' for developing economies to embark on their industrialization programme for economic growth.

2. Concept of Global Value Chains

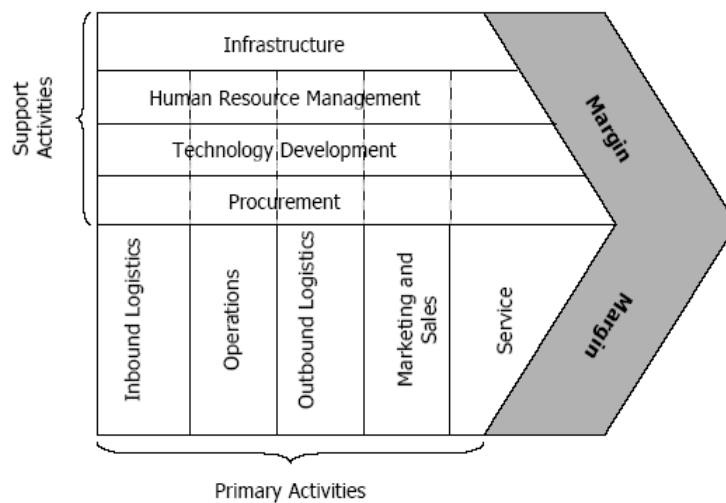
A useful conceptual device that helps us to understand how national and international business networks (including those established by MNCs) is the notion of 'global value chains'² (GVC). A value chain is a sequence of activities required to make a product or provide a service. The value chain concept is often attributed to Michael Porter who has introduced it in his book "Competitive Advantage: Creating and Sustaining Superior Performance" (Porter, 1985). Value chain analysis, as noted by Schmitz (2003), has become an increasingly useful approach to gain a comprehensive view of the various inter-locking stages involved from taking a good or service from raw material to production and then to the consumer.

Activities in a value chain can be categorized into primary and support activities. Primary activities include manufacturing, marketing, outbound logistics and service. The support activities are finance, human resource management, technology development and procurement (Figure 1).

Two points need to be stressed at this stage. Each of these value chain activities can be further divided to facilitate a more thorough analysis. Even if the firm does not perform all these activities in house, it still has to ensure that the outsourcing partner is efficient. Thus, more often than not, a thorough analysis of all the activities that make up the chain extending from the basic raw materials suppliers to the final end customer becomes necessary to identify scope for improvement and remove inefficiencies.

² A very useful description of the global value chain and global production network can be found in UNIDO working paper entitled "Inserting Local Industries into Global Value Chain and Global Production Networks: Opportunities and Challenges for Upgrading", available at http://www.unido.org/file-storage/download/?file_id=33079.

Figure 1: Porter's Value Chain



Source: Porter (1985).

Succinctly described by Schmitz (2003), the idea of a value chain becomes useful for analytical and policy purposes, once we include three further features. Firstly, the activities are often carried out in different parts of the world, hence the term global value chain. Secondly, some activities add more value and are more lucrative than others. Policy makers will be concerned as to how to help local enterprises to move into lucrative activities. The third feature concerns the power of actors in the chain. Some actors in the chain have power over the others. The powerful actors are often called the 'lead firms' who seek to 'govern' the chain. They set and/or enforce the terms under which the others in the chain operate. A central concern of value chain analysis is to 'unpack' the relationships between global lead firms and local producers – and the opportunities and constraints that result from entering such relationships.

While the value chain is important for all companies, in the case of global companies, a highly sophisticated and well-coordinated approach to value chain management becomes critical. This is because global companies have to locate different activities in different countries to optimize the effectiveness of the value chain as a whole.

Value chains can span firms of a local economy, a sub-national regional economy, the entire domestic economy and even the global economy since activities that comprise a value chain can be contained within a single firm or distributed among different firms within the countries or across different countries. When value chains in which activities are divided among multiple firms and spread across wide swaths of geographic space, these chains now made up a large interconnected system of value chains called the Global Value Chain (GVCs).

For developing economies, an approach to engender growth and development is to be able to plug into the GVCs. It pays to recognize which are the 'lead firms' in the GVC, and the governance³ of value chains, as these will enable appropriate strategies to be formulated and implemented in order for participation in the value chain possible. Able to secure a position in the value chain could well be the starting point for cycle of cumulative causation: from simple labor-intensive assembly activities to higher value-added, technology-based production.

There is a need to distinguish between global chains that are "driven" by two kinds of lead firms: buyers and producers. The GCC framework contrasted "buyer-driven" chains (such as large retailers like Wal-Mart) to "producer-driven" chains, dominated by large manufacturing firms, such as General Motors and IBM. Put simply, producer-driven chains have more linkages between affiliates of multinational firms, while buyer-driven chains have more linkages between legally independent firms. Underlying this distinction is the notion that buyer-driven chains turned out relatively simple products, such as apparel, house wares, and toys. Because innovation lies more in product design and marketing rather than in manufacturing know-how, it was relatively easy for lead firms to outsource production. In the more technology- and capital-intensive items made in producer-driven chains, such as autos and complex electronics, technology and production expertise were core competencies that needed to be developed and deployed in-house, or in captive suppliers that can be blocked from sharing them with competitors⁴.

Over the years, business practices among multinational enterprises have changed quite dramatically - outsourcing many activities and developing strategic alliances with competitors. They have become less vertically integrated and more network-oriented. Better global standards in the realms of business processes and product characteristics, and the heavy application of information technology in areas such as design, manufacturing, service provision, supply-chain coordination, and materials management, has enabled increased outsourcing in producer-driven chains and made it possible, and more compelling, for firms to forge modular linkages between buyers and suppliers in both producer- and buyer-driven chains.

2.1 Global Production Networks (GPNs)

³ Governance concerns questions relating to who decides what is produced, how are the rules of trade determined, and what is the nature of relationships between participants. Governance of the GVCs is discussed by Gereffi, Humphrey, and Sturgeon (2005). See also Kaufmann, D., Kraay, A., & Mastruzzi, M. (2007).

⁴ Another typology classified value chain into 4 different categories: (1) *Market-based*: enterprises deal with each other in arm's length transactions; (2) *Modular*: enterprises have complementary competences; no enterprise exercises control over others; (3) *Captive*: lead firm sets the parameters under which others in the chain operate; (4) *Hierarchy*: enterprises are vertically integrated; the parent company controls its subsidiaries.

The GVC concept is increasingly complemented by the Global Production Networks (GPNs) of specialized independent enterprises, capturing complex relationships and interrelations between firms that are of systemic nature; GVC deals with vertical and linear sequences of events along the value chains, while GPN deals with complex network structures in which there are intricate links – horizontal, diagonal, as well as vertical – forming multi-dimensional, multi-layered lattices of economic activity (Henderson, Dicken, Hess, Coe, and Yeung, 2002)⁵. On the other hand, D. Ernst defines GPN as a major innovation in the organization of international business, whereby these networks combine concentrated dispersion of value chain across the boundaries of the firm and national borders, with a parallel process of integrating hierarchical layers of network participants (Ernst and Kim, 2002).

The GPN concept reflects the processes of accelerated *fragmentation* in knowledge-intensive activities in some value chains. For instance, in product design and development, product technology is becoming increasingly modularized. Modularization of technological knowledge enables the adoption of characteristics of standard commodity, allowing design and other knowledge-intensive activities to be separated from the whole value-chain system and to be performed in different geographical locations (Ernst and Lüthje, 2003). Modularization on the other hand offers opportunities for firms in developing countries to participate in GPNs.

One of the benefits of participating in GPNs is knowledge diffusion. GPNs boost international knowledge diffusion by the transfer of knowledge from the global flagships or lead companies to their suppliers in developing countries (Rugman, 1997: p. 182). Flagships that can be “brand leaders” like GE and IBM, or “contract manufacturers” like Flextronics and General Electrics, typically provide the local suppliers with knowledge, which could assist them in building capabilities that are necessary to produce products and services with the expected quality and price. To stay on the GPNs, however, local suppliers must constantly upgrade their absorptive capacity (Ernst and Kim, 2002).

2.2 GVC and Industrial Upgrading

Participating in the GVCs and GPNs broadens the scope for getting gains from an open trade and investment regime, and thus diminishes pressures for protectionism. It can help developing country producers to enter foreign markets, earn more foreign currencies, diversify their exports, and most importantly to get new skills, knowledge and technology—all considered as key factors for productivity enhancement and growth. Late-comer firms from developing countries

⁵ It is important to clarify the concepts of a “chain” in GVCs and a “network” in GPNs. According to Sturgeon (2001), a chain maps the vertical sequences of events leading to the delivery, consumption, and maintenance of goods and services - recognizing that various value chains often share common economic actors and are dynamic in that they are reused and configured on an ongoing basis - while a network highlights the nature and extent of the inter-firm relationships that bind sets of firms into larger economic group.

Additional Input- New Paradigm of Economic Growth: Global Value Chain and Global Production Network (Singapore)

can exploit the advantage of their late arrival to tap into new technologies, rather than having to reproduce the entire previous techno-logical trajectory.

By recognizing the working and importance of GVC and GPN, policy makers and practitioners will have greater confidence in suggesting and implementing measures that contribute to successful industrialization and development. Understanding GVCs and GPNs offers opportunities for firms in developing countries to upgrade their technological and industrial capabilities so as to be able to participate in the global value chains and integrate into the global economy. Linking to global value chains can also provide countries better access to markets and to knowledge of leading players. (Borrus et al., 2000; Gereffi, 1994; Gereffi, 1995; UNIDO, 2005).

Concepts of GVC and GPN will also enable local entrepreneurs to take a more global view of business, thus production efficiency and managerial skills will likely to be raised and sustained in view of competition and standards demanded by clients beyond the local economy. Local producers will benchmark against competing firms in other countries and will also encourage learning from buyers. One can envisage local producers who join global value chains have good prospects for upgrading from assembly of imported components,

- (1) to taking care of the entire production process (including the sourcing of inputs),
- (2) to design of their own products,
- (3) to sale of their own branded products in national and global markets⁶.

In fact, we can identify five types of upgrading:

- Process upgrading: transforming inputs into outputs more efficiently by re-organizing the production system or introducing superior technology;
- Product upgrading: moving into more sophisticated product lines (which can be defined in terms of increased unit values).
- Functional upgrading: acquiring new functions in the chain (or abandoning existing functions) to increase the overall skill content of activities.
- Inter-sectoral upgrading: using the knowledge acquired in particular chain functions to move into different sectors.

⁶ See UNIDO working paper: "Inserting Local Industries into Global Value Chain and Global Production Networks: Opportunities and Challenges for Upgrading". See also Schmitz (2005) "Value-Chain Analysis for Policy Makers and Analysts. Geneva: ILO.

- Industrial Composition Upgrading: invitation of new industries (foreign and local) into the economy to increase diversity and economic sustainability

3. Production Networks in Southeast Asia

East Asia's production networks started in the 1960s and were initially concentrated on establishment of production units by multi-national companies (MNCs) especially those from U.S. for narrowly defined, labour intensive activities. In response to opportunities created by these investments, local companies were then formed to perform various tasks and produce a range of components or sub-systems defined by the MNCs. Soon this results in local affiliates of these companies operating with a high degree of local autonomy, and increasingly relied on nearby suppliers for specialized inputs to their manufacturing process (Borrus, 2000). Local firms continuously strove to extend their range of production and to integrate forward and backward from specific assigned points in the production chain, thus creating a dynamic and competitive local environment in many East Asian locations (Borrus, 2000). As suppliers from the core locations (e.g. Taiwan, South Korea and Singapore) gained specialized skills, they would extend their operations into less developed parts of East Asia (e.g., Malaysia, Indonesia, Thailand, and Southern China). This hence created a regional production network in East Asia.

The expansion of East Asian production networks through the region was due to several factors including geographic proximity and availability of skilled manpower. The heterogeneity of the East Asian economies also enabled international segmentation of production processes since the different countries had different comparative advantages. In the latter half of the 1980s, the Asian currency re-evaluations, which have affected the competitiveness of manufacturing industries in the most developed countries of the region, have accelerated the relocation of their labour intensive production to the low-wage countries of the region (Naughton, 1997). Trade policies in countries such as Thailand, Malaysia, Indonesia and the Philippines have also facilitated inward FDI in export-oriented business (Ando and Kimura, 2003).

In East Asia, examples of production networks can be seen especially in three sectors: textile and clothing (T&C); machinery; and automotive. For T&C, the relocation of segments of entire production processes started in the 1950s, with the move from North America and Western Europe to Japan followed by a switch to Hong Kong, Taiwan, and the Republic of Korea in 1970s. The bulk of the world T&C production was transferred to Mainland China, Indonesia, Thailand, Malaysia and the Philippines in late 1980s. These movements are mainly due to the fact that the industry's low capital and relatively high labour intensity make it attractive to locate several of its production blocks at newly industrialized economies rather than developed economies. The shares of Southeast Asia and that of China in the apparel imports of the United States, as the largest apparel-importer from the world, rose from eight to twelve per cent, and from eight to fourteen per cent, in 1983 and 2001 (Gereffi et al., 2002, pp. 30-31).

Additional Input- New Paradigm of Economic Growth: Global Value Chain and Global Production Network (Singapore)

In the area of machinery, some countries in Southeast Asia benefited early from the fragmentation of the production of machinery goods. As time passes, these countries shared these benefits with the rest of countries across Southeast Asia as the production blocks of machinery goods dispersed throughout Southeast Asia to take advantage of the differences in factor endowments in the fragmented production blocks between developing, emerging, and developed economies in the region. Share of intra-regional trade in machinery intermediates exports for East Asia, rose from 40 percent in 1990 to 58 percent in 2003 (WTO, 2005).

In the area of electronics, some countries in Southeast Asia benefited early from the fragmentation of the production of electronic products. As time passes, these countries shared these benefits with the rest of countries across Southeast Asia as the production blocks of electronics products dispersed throughout Southeast Asia to take advantage of the differences in factor endowments in the fragmented production blocks between developing, emerging, and developed economies in the region. The global share of exports of integrated circuits and electronic components for East Asia rose from 44 percent in 1990 to 48 percent in 2005 (WTO, 2006).

The production blocks of automotive industry is also increasingly fragmented throughout Southeast Asia. Automotive manufacturers started their production networks in Southeast Asia with the introduction of the ASEAN programs such as the 1988 Brand-to-Brand Complementarity (BBC) scheme and the 1996 ASEAN Industrial Cooperation (AICO) scheme which reduced tariffs on some intra-regional and intra-industry trade. The automotive production blocks in Southeast Asia differ from country to country in terms of the intermediate products produced. For example, Toyota used its affiliate in the Philippines as a base for specialized production of transmissions, its affiliate in Indonesia for gasoline engines, its affiliate in Malaysia for steering gears and electronic components, and its affiliate in Thailand for diesel engines and pressed parts. These parts and components are then assembled in the major automotive industry clusters in Southeast Asia, notably in Thailand and Indonesia.

A recent Study by Poapongsakorn and Techakanont (2007) on the Thai automotive industry provides interesting findings on the regional production network. The production and production capacity of automobiles in Thailand began rapidly in the late 1980s after the appreciation of the yen following from the Plaza Accord. It then accelerated in the early 1990s due to unprecedented economic boom and the government's liberalization policy. After the sharp decline during the 1997-98 Asian Financial Crisis, production jumped sharply and surpassed the 1996 peak in 2002. Several car-makers have also expanded their production capacity as they had already made a strategic decision to use Thailand as their global production bases in the early 1990s. Poapongsakorn and Techakanont emphatically argue that Thailand being able to join the global production network can be attributed to (1) the Thai government leadership in the Establishment of ASEAN Free Trade Area (AFTA) and ASEAN Industrial Cooperation (AICO); (2) the weak and fragmented sectoral economic policy formulation that has allowed the private sector to bargain with bureaucrats and with competing business groups; (3) the adoption and adaptation of Japanese public-private cooperation by Thai policy makers during the period of the foreign debt crisis in the early 1980s; (4) the industrial decentralization policy in the late 1980s, which was in response to congestion problems in Bangkok, and the

liberalization policy which took place in Thailand before other ASEAN economies began to follow suit.

Table 1: Benefits from the Production Networks for the Auto Parts Firms

Benefits from the Production Network for the Auto Parts Firms	
<i>Benefits</i>	<i>Percent</i>
1. Benefits from being part of the auto network	
– technical assistance from auto-makers	50
– economies of scale	42.8
– more clients/market diversification	7.1
2. How does the network membership affect you as the parts supplier?	
– Productivity	
– (a) increase significantly	33.3
– (b) increase slightly	33.3
– (c) no impact	20.0
– (d) uncertain	13.3
– Product engineering, VA, VE	
– (a) increase significantly	20.0
– (b) increase slightly	46.7
– (c) no impact	20.0
– (d) uncertain	13.3
– Engineering change and design capacity	
– (a) increase significantly	13.3
– (b) increase slightly	53.3
– (c) no impact	26.7
– (d) uncertain	6.7
– Production problem	
– (a) increase significantly	20.0
– (b) increase slightly	6.7
– (c) no impact	33.3
– (d) uncertain	40.0
– Defect rate	
– (a) decrease significantly	33.3
– (b) decrease slightly	13.3
– (c) no impact	40.0
– (d) uncertain	13.3
3. Percentage of parts shipments to the car-makers that are on-time	97.0
4. Do the car-makers manage to unload your shipments on time?	
– (a) on time	96.6
– (b) quite late	75.5
– (c) occasionally late	8.3
5. Has the auto-maker delay the shipment schedule?	1.29
Source: Survey of the Auto parts Firms in the East, January–February 2007.	

The cluster of auto-makers in the production network helps to spawn a large number of auto-parts suppliers. For instance, the auto-maker Toyota alone reported it has 115 auto-parts suppliers. Table 1 identifies the benefits auto-parts suppliers derive from the production network. The major benefits from being a production network member are technical advice from auto-

makers (50 % of the respondents) and economies of scale arising from a larger volume of business (42.8% of the respondents). This explains why the network membership can significantly enhance the productivity of 33 percent of the sampled firms, and significantly reduces defect rates in most companies (33 %). Other benefits are increases in product engineering changes and design capacity (46.7 %). Moreover, the just-in-time practice has allowed 97% of the sampled firms to deliver their parts supplies to the auto-makers' factories on time⁷.

4. Conclusion

Trade and investment liberalization is known to be able to facilitate firms to enjoy economies of scale. This in turn will generate resources and provide opportunities for technological upgrading and transfer, productivity improvement and further external market penetration. Regional economic cooperation in streamlining custom procedures, harmonization of tariff, and improving connectivity and logistic infrastructure will create conducive environment for development of production network and value-chain. Case studies relating to automobile makers and automobile parts in Thailand, have shown substantial gain can be reaped from well-organized production network complemented by pro-active government policies.

⁷ For more extant discussion of the survey results, see Chapter 7 of "Production Networks and Industrial Clusters: Integrating Economies in Southeast Asia, edited by I. Kuroiwa and Toh M.H. ISEAS & IDE-JETRO, 2008.

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