

**Executive Summary**  
**The Assessment of the Formation of East Asian Free Trade Agreement (EAFTA)**  
**and the Position of Thailand**

**1. Background of the Study**

According to international trade economics theories, partner countries shall reach mutual benefit from trade between each other when such trade is carried out on a truly liberalized-trade basis, where none of trade barriers are implemented. In practice, however, there exist various tariff and non-tariff barriers, such as tariff wall, protection measures for domestic goods and services, unfair competition prevention laws, or high environmental and sanitary standards. Although efforts in reducing these barriers in order to achieve ideal international trade have been made through the establishment of the World Trade Organization (WTO), a multilateral institution functioning as an important negotiation stage, there has been, the slow down of multilateral trade negotiations over recent years.

Under such situation, bilateral negotiations, as well as multilateral negotiation which involve fewer partners than those of WTO, have become increasingly important. According to WTO, in May 2004 there are over 265 bilateral and multilateral free trade agreements. Also, it is expected that by 2006 there will be 300 agreements.

The Government of Thailand also sees the opportunities and benefits from such forms of negotiations. The country has thus begun free trade negotiations with 8 countries and 1 group of countries: (1) FTA frameworks have been signed with 5 countries (China, Bahrain, India, Peru, and Australia); (2) Official negotiations have been initiated in 2004 with 3 countries (USA, Japan, and New Zealand), and 1 group of countries (BIMST-EC). Besides, Thailand, as a member of ASEAN, is also going through ASEAN-China FTA negotiations. Also, ASEAN Plus Three (APT) agreement, which involves ASEAN and the 3 countries in Plus Three group, i.e., China, Japan and South Korea, is another agreement which should be focused as it is the basis for the formation of East Asia Free Trade Agreement (EAFTA).

APT FTA negotiation is considerably important as it will create an economic region with 2,015.2 million consumers and thus turning East Asia into a strategic area which could attracts investment from other regions. This eventually will bring about benefits to member countries in the region as well as Thailand.

In order to ensure that Thailand could secure sufficient benefits from the prospective formation of EAFTA, and to ensure that the country has necessary information and guidelines to support decision making agencies, in terms of scope of liberalization, modalities, negotiation strategies, and capacity building for Thai industries, the Department of Trade Negotiations has therefore assigned Chula Unisearch to conduct the study in the project entitled: "The Assessment of the Formation of East Asian Free Trade Agreement (EAFTA) and the Position of Thailand".

## **2. Methodology**

### **2.1 GTAP Model**

As Free Trade Agreement is aimed at reducing trade barriers among member countries, it is necessary to study the effects of FTA on various factors, e.g. production, prices, import, export, and Gross Domestic Product (GDP). Also, it is important to consider the impacts on production sectors, and on trade and investment between member and non-member countries. Due to such complexity, General Equilibrium Model is used to simulate the effects of FTA. This study makes use of the widely-used Global Trade Analysis Project (GTAP), which is a multi-region and multi-sector model. It is a Computable General Equilibrium co-developed by Perdue University (USA) and Monash University (Australia). GTAP database contains 66 regions, each comprising 57 sectors and is linked through the export, import and international capital flow.

### **2.2 Diamond Model**

Michael E. Porter's Diamond Model is used for analyzing the competitive advantage of the industries in this study. According to Porter, the competitive edge depends on the dynamic relationship among the following four determinants: (1) firm strategy, structure and rivalry; (2) demand conditions; (3) related and supporting industries; and (4) factor conditions. Besides, an external force which also influences the above determinants is government.

### **2.3 SWOT Analysis**

In order to provide recommendations on negotiation strategies, SWOT analysis framework is applied. The tool, which analyzes the operating environment of a firm through the 4 factors, namely Strength, Weakness, Opportunity, and Threat, is widely used in formulating business/corporate strategies.

## **3. ASEAN+3 Trade in Goods and Services**

### **Trade in Goods**

ASEAN is the second largest trade partner of +3 countries. The highest values of trade can be seen in 5 ASEAN members, namely Indonesia, Malaysia, Philippines, Singapore, and Thailand. Among these countries, Malaysia is the largest trade partner of +3 countries, while Thailand is in the fourth rank. On the other hand, trade values between the other 5 members of ASEAN, namely Brunei, Vietnam, Myanmar, Cambodia, and Laos are lower. However, Cambodia's and Vietnam's average growth rate of trade is high, while Laos, of which trade values with +3 is the lowest, experiences negative growth rate of trade in goods.

In 2004, export values from +3 countries to ASEAN is \$US 1.39 billion. The products with the highest export values are electrical machinery, machinery, vehicles,

iron and steel, optical and medical instrument, plastic, mineral fuel, organic chemicals, iron and steel products, and ships and boats, respectively. These products have total export values of \$US 106 billion, or 76.13% of total export values.

The values of import from ASEAN in 2004 are \$US 153 billion. The products with the highest import values are electrical machinery, mineral fuel, machinery, wood, plastic, rubber, organic chemicals, optical and medical instrument, fats and oil, and fish and seafood, respectively. These products have total import values of \$US 124 billion, or 81.53% of total import values.

The above trade relations between ASEAN and +3 countries reflects the pattern of intra-industry trade within the region. Besides, the products with 80% share of total trading values can be categorized into 7 major industries: automobile, petrochemical, textile and apparel, gems and jewelry, food, IT, and machinery industries.

**Table 1**  
**Trade in Goods between ASEAN and +3 Countries**

Unit : \$US Million

No.	+3 Countries Exports to ASEAN			+3 Countries Imports from ASEAN		
	Product	Value	Share (%)	Product	Value	Share (%)
1	Electrical machinery	40,549.01	28.97	Electrical machinery	46,930.78	30.70
2	Machinery	27,108.20	19.37	Mineral fuel	31,903.36	20.87
3	Vehicles, not railway	9,757.14	6.97	Machinery	19,374.32	12.67
4	Iron and steel	8,632.00	6.17	Wood	5,365.64	3.51
5	Optical and Medical Instrument	4,581.61	3.27	Plastic	5,202.76	3.40
6	Special item	4,495.61	3.21	Rubber	4,174.78	2.73
7	Plastic	4,418.16	3.16	Organic chemicals	3,634.28	2.38
8	Mineral fuel	4,341.60	3.10	Optical and Medical Instrument	2,912.95	1.91
9	Organic chemicals	2,756.17	1.97	Fats and oils	2,705.88	1.77
10	Iron, steel products	2,737.78	1.96	Fish and seafood	2,454.27	1.61
11	Ships and boats	1,676.90	1.20	Special item	2,110.41	1.38
12	Misc. chemical product	1,496.47	1.07	Ores, slag, ash	1,877.25	1.23
13	Inorg chemical	1,374.03	0.98	Misc. chemical product	1,341.38	0.88
14	Aluminum	1,319.83	0.94	Meat	1,203.43	0.79
15	Rubber	1,248.41	0.89	Furniture	1,157.14	0.76
16	Copper	1,189.71	0.85	Paper, paperboard	1,121.38	0.73
17	Manmade filament	1,174.14	0.84	Copper	1,108.36	0.72
18	Precious stones	1,146.93	0.82	Edible fruit and nuts	1,045.62	0.68
19	Cotton, yarn, fabric	1,059.09	0.76	Woodpulp	923.74	0.60
20	Knit apparel	968.58	0.69	Vehicles, not railway	847.04	0.55
	Other	9,175.18	6.56	Other	15,496.08	10.14
	<b>Total</b>	<b>139,969.26</b>	<b>100.00</b>	<b>Total</b>	<b>152,890.84</b>	<b>100.00</b>

Source : World Trade Atlas, 2004

## Trade in Services

The structure of trade in services among ASEAN countries and +3 countries (China, Japan, and South Korea) can be shown in 2 areas, which are services trade balance, and key service sectors of each country.

**Table 2**  
**The Services Trade Balance**  
**and Key Service Sectors of ASEAN+3 Countries**

Country	The Services Trade Balance	Key Service Sectors
Cambodia	<ul style="list-style-type: none"> <li>• Cambodia is a net importer of most services, except transport, which the country is a net exporter and from which the foreign revenue tends to increase continuously.</li> </ul>	<ul style="list-style-type: none"> <li>• According to the employment figure in 1998 – 2002, key service sectors are:               <ol style="list-style-type: none"> <li>1. Wholesale and retail trade</li> <li>2. Government administration</li> <li>3. Transport and telecommunication</li> </ol> </li> </ul>
Indonesia	<ul style="list-style-type: none"> <li>• Indonesia is a net importer of almost all service sectors, except transport, of which the country is a net exporter and which earns over \$US 1 billion annually.</li> </ul>	<ul style="list-style-type: none"> <li>• According to 2000 – 2003 GDP share, key service sectors are:               <ol style="list-style-type: none"> <li>1. Wholesale and retail trade</li> <li>2. Other services</li> <li>3. Financial and business</li> </ol> </li> </ul>
Malaysia	<ul style="list-style-type: none"> <li>• Malaysia is a net importer of almost all service sectors, except transport, which is in surplus over \$US 4 billion.</li> </ul>	<ul style="list-style-type: none"> <li>• According to the employment figure in 2000 – 2004, key service sectors are:               <ol style="list-style-type: none"> <li>1. Government service</li> <li>2. Construction</li> <li>3. Financial, insurance and business</li> </ol> </li> </ul>
Philippines	<ul style="list-style-type: none"> <li>• Service sector of Philippines is considered important and contributes over 50% of annual GDP.</li> <li>• Philippines is a net importer in service sector, with transport and telecommunication as only 2 sectors in which the country is a net exporter.</li> </ul>	<ul style="list-style-type: none"> <li>• According to the number of establishment in 1999 – 2000, key service sectors are:               <ol style="list-style-type: none"> <li>1. Wholesale and retail trade</li> <li>2. Hotel and restaurant</li> <li>3. Real estate and other business activities</li> </ol> </li> </ul>
Singapore	<ul style="list-style-type: none"> <li>• Singapore has limitation about land area, service sector is thus important to the economy, contributing over 70% of annual GDP.</li> <li>• Unlike other ASEAN countries, Singapore is a net exporter of services. Also, the sector of</li> </ul>	<ul style="list-style-type: none"> <li>• According to the employment figure in 2002 – 2003, key service sectors are:               <ol style="list-style-type: none"> <li>1. Wholesale and retail trade</li> <li>2. Transport</li> <li>3. Restaurant</li> </ol> </li> </ul>

Country	The Services Trade Balance	Key Service Sectors
	Singapore which posts surplus is financial service while other ASEAN countries' is transport.	
Thailand	<ul style="list-style-type: none"> <li>According to service trade balance and transfer of Thailand in 2002, Thailand is a net importer in service sector.</li> </ul>	<ul style="list-style-type: none"> <li>According to the number of establishment in 2002, key service sectors are: <ol style="list-style-type: none"> <li>Retail sale</li> <li>Manufacturing</li> <li>Hotel and restaurant</li> </ol> </li> </ul>
China	<ul style="list-style-type: none"> <li>China has service trade surplus in 1999 – 2000 but has service trade deficit in 2003. The country is a net exporter in transport, communication, construction, IT and Computer sectors, which are the competitive sectors of China.</li> </ul>	<ul style="list-style-type: none"> <li>According to the number of establishment in 2002 - 2003, key service sectors are: <ol style="list-style-type: none"> <li>Social services</li> <li>Wholesale and retail trade and restaurant</li> <li>Real estate</li> </ol> </li> </ul>
Japan	<ul style="list-style-type: none"> <li>Japan is a net importer in almost all service sectors, except construction, financial and other rights of which the country is a net exporter and key competitor.</li> </ul>	<ul style="list-style-type: none"> <li>According to the employment figure in 1999, key service sectors are: <ol style="list-style-type: none"> <li>Laundry, beauty, and bathing station</li> <li>Professional services</li> <li>Entertainment</li> </ol> </li> </ul>
South Korea	<ul style="list-style-type: none"> <li>Service sector is important to the economy of South Korea, contributing around 50% of GDP.</li> <li>In 2002, South South Korea posted trade deficit in every service sector, except transport, consultancy, and financial consultant</li> </ul>	<ul style="list-style-type: none"> <li>According to the number of establishment in 1999 - 2003, key service sectors are: <ol style="list-style-type: none"> <li>Wholesale and retail trade</li> <li>Transport</li> <li>Other community and individual services</li> </ol> </li> </ul>

Source: Summarized from Annex A of the Final Report

From the structure of services trade shown in the above table, some key issues can be drawn as follows:

- Most ASEAN+3 countries have services trade deficit. However, all countries, except Singapore, South Korea, and Japan, have trade surplus in tourism sector. This show that tourism is the largest foreign revenue earner of ASEAN countries and China.
- Deficit in tourism services are common among Singapore, South Korea, and Japan as the three countries are the major sources of tourists in the

region. For Singapore, it is obvious that competitive service sectors are construction and financial sectors, where Singapore is a net exporter. South Korea is a net exporter in transport, financial and consulting services while Japan is a net exporter in financial, construction and royalties and license services.

- In the case of Brunei, Laos, Myanmar, and Vietnam, it can be said that service sector is less important than agriculture and industry sector. This not only reflects the development level of Laos, Myanmar, and Vietnam, but also shows the dependence of Brunei economy on the trade of petroleum and related products.

For investment in production sectors of ASEAN and +3 countries, some significant observation can be drawn as follows:

- It is obvious that investment profile in each country is related to the development level of the country as well as its trade structure. For instance, for developed countries, such as Singapore and Japan, investment in service sector, particularly in financial services of both countries, is high in proportion. On the other hand, FDI of ASEAN countries, except Singapore and Indochina countries, as well as China, is high in industry sector as these economies still depend on the sector.
- Comparing to ASEAN countries, Brunei is an exceptional case as it has petroleum resources. Brunei economy has heavy reliance on petroleum trade, putting industry sectors as a lower priority area to be developed. Investment in Brunei, thus, is high in mining and petroleum industry, especially oil extraction.
- For Malaysia, the highest proportion of FDI is seen in electronics sector, followed by petroleum and gas sector. This reflects that Malaysia is a manufacturing base of electronic goods. Also, its economy to some extent relies on trade of petroleum.
- For new ASEAN members, or Indochina countries, it is clear that most FDI flows into agriculture or primary production, e.g. mining industry, fishery, forestry, which is labor-intensive. Myanmar, as well as Cambodia, of which the highest FDI is shown in forestry industry, are good examples. Moreover, agriculture sector in these countries contributes to more than 50% of the countries' GDP. Investment, therefore, is clearly intensive in these sectors.
- For China, more than half of FDI flows into manufacturing sector, showing China's potential in attracting overseas business firms to use the country as a manufacturing base.

Additional issues on FDI can also be presented as follows:

- Key investors in ASEAN countries are Japan, USA, Singapore, and Netherland while key investors in +3 countries are also USA, Singapore, and Netherland.
- When considering investment among ASEAN+3, Japan is a key investor in ASEAN countries. Most investment from Japan is seen in automobile and parts, machinery, and electronics industry. Also, it is intensive in ASEAN 5 countries, namely Singapore, Indonesia, Malaysia, Philippines, and Thailand. Japan investment reflects its business strategy, which is the expansion of production network in the region in order to remain competitive in the industry.

#### 4. Government roles and measures in ASEAN+3 countries

In general it is clear that the governments of ASEAN+3 countries adopt trade liberalization policy, which includes both trade and investment liberalization. However, the level of liberalization is different from one country to another. In Indochina countries, for instance, trade limitations, especially tariff measures, as well as import and export procedures and regulations, still exist. In other countries, non-tariff barriers are more dominant.

For tariff measures, **Singapore is the country utilizing the least tariff barriers, followed by Japan. However, in Japan, certain tariff barriers are still used to protect its agriculture sector.** ASEAN -4 countries, namely Indonesia, Malaysia, Philippines, and Thailand impose lower tariff average rate for both agriculture and industry sectors when compared to China, South Korea, Vietnam, and Indochina countries. This is due to the implementation of tariff reduction schedule under ASEAN Free Trade Area (AFTA). Besides the above issues, it is also obvious that **South Korea is another country which imposes tariff measure to protect its agriculture goods, especially value-added and fishery products.**

For non-tariff barriers, each country obviously imposes measures which are different. **Anti-dumping measures, for instance, are imposed by China for various products,** whereas in Japan they are less utilized. In addition, while NTBs are not the measures often imposed by Brunei, they are major measures included Vietnam trade policy. However, ASEAN+3 countries do share some similarities in NTBs. Some products are prevented from entering into the countries' domestic market by certain measures, e.g. quotas, or government permission for import of the products. Besides, intellectual property protection is another measure utilized through legal instruments of the countries, though without much effective result. Moreover, cumbersome custom procedures in many ASEAN countries are often criticized as a trade obstacle. Many countries, such as Philippines and Thailand, have thus put an effort in improving their custom procedures through the use of IT system. For government procurement, it is clear that Malaysia, China, Philippines, and Thailand provide privilege to domestic entities while fair and transparent regulations in such government procurement is seen in Singapore and Japan.

Though there are many differences in the roles or measures implemented by the governments of ASEAN+3 countries, there is one common policy adopted, which is the support of investment. This policy is quite clearly stated by every country, except Cambodia, where Board of Investment, including certain investment facilitation measures, were established but without specified industry to be supported. For the other 2 Indochina countries, Laos encourages investment in every industry while Myanmar encourages investment in petrochemical, pharmaceutical, steel, machinery, leatherwear, and telecommunication equipment industries.

Some ASEAN+3 countries utilize tariff measure, together with other measures, such as government subsidies, to attract foreign investment. However, the industries which are supported are different in each country. China, for example, focuses its facilitation in technology intensive industries, which is in line with the country's industry development policy. For Thailand, investment facilitation is seen in strategic industry of the country, such as food industry. For Brunei, the support for investment is seen in industries which is based on natural resources, as well as other manufacturing (non-petrochemical) industries, and service business, such as those related to human resource development.

In addition to the above observations, it is clear that many countries have specified strategic industries to be developed. For instance, South Korea divides its industries into 3 categories – primary industry, future industry or IT/biotechnology-based industries, and supporting service industry. The policies adopted to develop these industries are different. The policy for primary industry is aimed at restructuring the manufacturing scheme to achieve higher productivity while that for future industry focuses on technology R&D, which is a critical success factor of the industry. For supporting service industry, the government aims to facilitate the development of services which support manufacturing industry, e.g. distribution, logistics, and e-commerce.

For Singapore, due to its limited land availability, the country is not the target area for setting production base. Singapore thus focuses its policy on the development of service sector, e.g. financial and banking services. Besides, due to its strategic location for product distribution, the country becomes an important port, rendering transportations and logistics to become the focus of Singapore service sector development.

For Thailand, there are 5 strategic industries which the government aims to develop, i.e. food, fashion, software, automobile, and tourism industries. Besides, the country also emphasizes industrial restructuring, aiming to develop the industries through cluster-based policies, instead of industry-based means. For Malaysia, petrochemical, electronics, transportation and telecommunications industries are its strategic industries.

## 5. Current status of FTAs negotiations between ASEAN and +3 countries

### 5.1 ASEAN - China FTA - Progress

Leaders of ASEAN and China have signed the Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between the ASEAN and China, and the Agreement on Dispute Settlement Mechanism, in the 10<sup>th</sup> ASEAN summit at Vientiane, Laos during November 29-30, 2004. The agreement covers the liberalization of trade in all goods and has come into force since 1 January 2005. The tariff reduction has been effective since 1 July 2005. The products under tariff reduction scheme can be divided into 2 categories:

- **Normal Track:** consisting of almost all items of member countries. Tariff cut shall start on 1 July 2005<sup>1</sup> and tariff shall reach 0% by 1 January 2010 for original members of ASEAN and China, and by 1 January 2015 for new ASEAN members.

Products are classified by applied MFN tariff rate as of 1 July 2003. Each category has different sets of schedule for tariff reduction/ elimination. Tariff rate of items which at present has high tariff rate will be brought to 0% later than those with lower tariff rate. Original members of ASEAN, or ASEAN-6, and China could still have tariffs on up to 150 items until the rate reach 0% within 1 January 2012. For new ASEAN members, or CLMV countries, more items could be included in the list and longer timeframe for tariff reduction/ elimination is allowed.

**Table 3**  
**Modality for Tariff Reduction/Elimination**  
**for Tariff Lines Placed in Normal Track for ASEAN - 6 and China**

X = Applied MFN tariff Rate	ACFTA Preferential Tariff Rate (Not later than 1 January)			
	2005*	2006	2007	2008
$X \geq 20\%$	20	12	5	0
$15\% \leq X < 20\%$	15	8	5	0
$10\% \leq X < 15\%$	10	8	5	0
$5\% < X < 10\%$	5	5	0	0
$X \leq 5\%$	Standstill		0	0

Notes : \* The first date of implementation shall be 1 July 2005

Source: Ministry of Commerce, Thailand

As an integral part of its commitments to reduce and/or eliminate the applied MFN tariff rates in accordance with the relevant Schedules, each Party also commits to undertake further tariff reduction and/or elimination in accordance with the following thresholds:

<sup>1</sup> China has postponed tariff reduction schedule to commence on 20 July 2005.

- (1) Each Party shall reduce to 0-5% not later than 1 July 2005 the tariff rates for at least 40% of its tariff lines placed in the Normal Track.
- (2) Each Party shall reduce to 0-5% not later than 1 January 2007 the tariff rates for at least 60% of its tariff lines placed in the Normal Track.

▪ **Sensitive Track:** Items which a Party is not ready to include in Normal Track are placed in Sensitive Track. The number of tariff lines which each Party can place in the Sensitive Track shall be subject to a maximum ceiling of:

- (1) ASEAN – 6 and China, 400 tariff lines at the HS 6-digit level and 10% of the total import value, based on 2001 trade statistics
- (2) Cambodia, Lao PDR and Myanmar: 500 tariff lines at the HS 6-digit level; and
- (3) Viet Nam: 500 tariff lines at the HS 6-digit level, and the ceiling of import value shall be determined not later than 31 December 2004.

Reduction of tariffs of products in Sensitive List is going on a slower pace than those in Normal Track. The tariff rate imposed on these items shall be reduced to 20% not later than 1 January 2012, and subsequently to 0-5% by 1 January 2018.

#### Highly Sensitive List

Tariff lines placed by each Party in the Sensitive Track shall be further classified into Sensitive List and Highly Sensitive List. **ASEAN – 6 countries and China shall have no more than 100 items listed in Highly Sensitive List, or 40% of the total number of tariff lines in the Sensitive Track, whichever is lower.**

Tariff rate of items in Highly Sensitive List shall be reduced to 50% by 1 January 2015.

**Table 4**  
**Modality for Tariff Reduction/Elimination**  
**for Tariff Lines Placed in Sensitive Track for ASEAN – 6 and China**

Product / Year	Tariff Rate under Agreement on Trade in Goods of ASEAN-China FTA
Sensitive Track	
2012	20%
2018	0-5%
Highly Sensitive List	
2015	50%

Source: Ministry of Commerce, Thailand

ASEAN – 4 countries, which are the new ASEAN members, shall receive flexibility in terms of both the number of items and timeframe for tariff reduction.

- **Reciprocal Tariff Rate for Tariff Lines Placed in Sensitive Track**

Tariff lines placed in Sensitive Track by a Party shall be excluded from normal tax privilege granted by other Parties under ASEAN-China FTA. Instead, applied MFN rate shall be imposed on these products when imported by other Parties.

The reciprocal tariff rate treatment of tariff lines placed by a Party in the Sensitive Track shall be governed by the following conditions:

- (1) the tariff rate for a tariff line placed by a Party in the Sensitive Track must be at 10% or below in order for that Party to enjoy reciprocity;
- (2) the reciprocal tariff rate to be applied to a tariff line placed by a Party in the Sensitive Track shall be either the tariff rate of that Party's tariff line, or the Normal Track tariff rate of the same tariff line of the other Party or Parties from whom reciprocity is sought, whichever is higher; and
- (3) the reciprocal tariff rate to be applied to a tariff line placed by a Party in the Sensitive Track shall in no case exceed the applied MFN rate of the same tariff line of the Party or Parties from whom reciprocity is sought.

Apart from modality for tariff reduction/elimination, trade in goods agreement, each Party also committed to undertake other provision, e.g. rules of origins, removal of quantitative restrictions and reduction/elimination of NTBs, safeguard measures, recognition of China's market economy status and refraining from application of the Protocol of Accession of the People's Republic of China to the WTO, and review of the Sensitive Track in 2008 with a view to improving liberalization level, e.g. by reduction of products in the Sensitive Track and the conditions governing the reciprocal tariff rate treatment of products placed by a Party in the Sensitive Track.

## **5.2 ASEAN - China FTA - Key Considerations**

- According to *Forging Closer ASEAN-China Economic Relations in the Twenty-First Century*, the report submitted by ASEAN-China Expert Group on Economic Cooperation (2001), ASEAN-China FTA will create a large economic region. Also, the removal of trade barriers will increase intra-regional trade, economic efficiency, and investment in the region. Besides, it will support economic stability in East Asia and allow both ASEAN and China to have a larger voice in international trade affairs. Thus both parties agreed to establish ASEAN-China FTA.
- According to the Global Trade Analysis Project (GTAP) simulations conducted in the above paper, real GDP increases for all ASEAN countries and China. This signifies a prospect from ASEAN-China FTA for both parties.

- When considering changes in trade among ASEAN countries and China by sector, the biggest gainers in terms of both import to and export from China are textiles and apparel, electrical appliances and machinery and other manufactures. This reflects that these sectors are significant in intra-regional trade structure and shows trade prospects for both parties.
- For Thailand's food industry, processed food which relies on domestic raw material will remain competitive, especially with competing products from China which have quality disadvantage. Nevertheless, it is necessary for the government to formulate appropriate strategy for the industry, i.e. the launch of marketing campaign and PR activities, or the development of manufacturing process. This is because liberalization of investment in the future will create an opportunity for China to receive transferred technology and know-how which will thus improve China's industries as well as its product quality.
- However, certain industries of Thailand, such as electronics, or textile and apparel, may experience negative impacts from the establishment of ASEAN-China FTA. This is due to the access into domestic market by cheaper products or parts from China.
- In conclusion, from the level of competitiveness of each sector in China and ASEAN countries, as well as their opportunity to receive investment, it is appropriate for ASEAN to consider China as a partner, rather than competitor. This is because after the establishment of FTA, ASEAN countries will function as components in value chain for several industries of China, namely textile, steel and products, leather and leatherwear, chemicals, electrical components, and plastic, which China relies on raw material and parts for manufacture sector from ASEAN countries.
- Besides, for some industries or products, ASEAN and China has complementary trade relationship. For example, the trade of fresh fruit between China and Thailand, where each country exports different fruits and serve as a market for each other. Therefore, the establishment of FTA will bring about trade growth in these industries or products.
- ASEAN's goods and services which have comparative advantages should be developed continuously. These include mining products and petroleum, high-technology products, e.g. semiconductor, electronics parts, and natural resources – based products, e.g. wood and paper, food and products, steel and products, leather and leatherwear, chemicals, plastic, and services. (This advantage results from either English-speaking labor, or abundant natural resources in ASEAN countries.
- In addition, many ASEAN countries, including Thailand, are facing labor-cost disadvantage when compared to China. Thus, the strategy implemented should not focus on cost competition with China, but on the development of product quality to increase value-added and expand the market in China. For example, developing high-end market for gems and jewelry industry and leatherwear of Thailand, and improving the efficiency,

management, logistics, and regulations, developing labor skill and technology used.

### **5.3 ASEAN - Japan FTA – Key Considerations**

The establishment of ASEAN - Japan Comprehensive Economic Partnership is still in the beginning state. Following USA, Japan is the second most important country in world economy. For ASEAN and Japan, during the past decades, both parties show closer trade relationship between each other, especially in terms of the building of production network, which is an important strategy for Japan to remain competitive in world market.

There are many research and studies about the establishment of AJCEP and some key issues can be drawn as follows:

- (1) AJCEP will bring about trade expansion and economic growth, as well as, increase in welfare, for both ASEAN and Japan. ASEAN in particular will have relatively higher increase in exports and economic growth.
- (2) The expected rates of return for both ASEAN and Japan will increase as a result of increasing domestic demand.
- (3) GDP will increase by 1.99% for ASEAN and by 0.07% for Japan.
- (4) Welfare will increase by US\$ 4.59 billion (0.13%) for Japan and by US\$ 5.9 billion (2.61%) for ASEAN from the base year of 1997.
- (5) The export volume from ASEAN to Japan will increase by US\$ 20.63 billion while the export volume from Japan to ASEAN will increase by US\$ 20.02 billion.
- (6) The establishment of AJCEP will increase investment in both parties and thus result in capital accumulation, which is an important factor for the development of the economy. ASEAN will have 3.33% increase in capital accumulation while Japan's increase is 0.08% of that of base year (1997).
- (7) An increase in foreign direct investment will also bring about technology transfer and will enhance its domestic productivity and competitiveness of the country.
- (8) Besides economic benefits, AJCEP will also render other advantages. For example, it will bring about the presence of ASEAN and Japan in the international community and will contribute to regional stability and security through economic development.

#### **Some key considerations drawn from relevant studies and research.**

- Most studies suggest that the formation of AJCEP will bring about benefits to both parties due to the removal of trade barriers, which eventually will

result in efficient division of labor. While Japan exports products requiring high technology and high-skilled labor, ASEAN countries export food, natural resources, and light manufacturing products which does not require high skilled labor. This will therefore increase rates of return and attract investment into the region.

- The reduction/ elimination of trade barriers will also cause trade expansion, provide consumers with access to cheaper goods, and increase welfare and economic expansion rate.
- Some studies, for instance, Hong<sup>2</sup>, use GTAP Model to study the impacts of bilateral FTA between ASEAN and each of +3 countries. In this study, 2 experiments are set up: (1) Preferential Free Trade Area, which include rice, an important agricultural goods for ASEAN countries, namely Thailand, Vietnam, and Japan; and (2) Non-rice Preferential Free Trade Area. It is found that both ASEAN and Japan gain in terms of welfare in both experiments. However, the inclusion of rice in FTA arrangement will render more benefits. Japan's welfare will improve by \$US 1.89 billion while that of ASEAN will improve by \$US 0.93 billion.
- Nevertheless, some studies, e.g. TDRI's *The Development of Methodology for Studying Impacts of Bilateral FTA on Industry Sector 2004*, indicates negative impacts from AJCEP. For example, it will cause a new round of bankruptcy, an increase in transaction costs due to changes of domestic and intra-regional manufacturing pattern when the country shifts to the production of competitive products after trade liberalization, and loss of tax revenues. However, it is important to note that there has not been any research which studies this loss. Moreover, another impacts from AJCEP is the larger gap of revenue distribution in the region.
- Many studies, e.g. Kitti Limskul's *Japan-ASEAN Comprehensive Economic Partnership*, Hank Lim's *Singapore's Perception of ASEAN-Japan Comprehensive Economic Partnership*, ASEAN's *Free Trade Areas with the PRC and Japan: Prospects and Challenges*, and *Macroeconomic Effects of the East Asian FTA: An Econometric Analysis* , suggest some important issues as follows:
  - For ASEAN, the impacts of AJCEP depends on many factors. For example, the capacity building in terms of technology, and the enhancement of competitiveness of ASEAN countries so as to be ready for increasing technological transfer.
  - If ASEAN countries does not prepare themselves in the above directions, the benefits and investment from AJCEP will shift to China and ASEAN will thus receive less benefit
  - Japan uses dual track strategy in the formation of FTA. That is to say the country is negotiating with individual ASEAN member countries, as well as with ASEAN as a whole. This may cause

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<sup>2</sup> Hong, Yiseok. The Economic Effects of Bilateral Free Trade Areas among ASEAN, China, Japan and South Korea.

Spaghetti Bowl Effect, affecting the member countries which start negotiations later than others.

- It is also important to strengthen closer cooperation in ASEAN so as to increase ASEAN's role in FTA negotiations. For example, it is appropriate to set up Single Overall Framework to be used in bilateral negotiations with other countries to ensure benefits for ASEAN.

#### **5.4 ASEAN – Korea FTA – Current Progress**

After 5 meetings of ASEAN - KOREA FTA Expert Group since March 2004, official negotiation for the formation of ASEAN - KOREA FTA has commenced during February 23-25, 2005, at Jakarta, Indonesia. Key issues can be concluded as follows:

- (1) The negotiation is the first round conducted in order to reach the finalized FTA within 2 years, starting from 2005.
- (2) Representatives of both parties agree in principle on tariff reduction for around 80% of all items within 2010 in accordance with the Framework Agreement for ASEAN-Korea FTA. The above tariff cut schedule is faster than that of ASEAN-China FTA and AJCEP.
- (3) The negotiation is based on the joint study of the expert group. It suggests that both parties will benefit from the formation of ROK-ASEAN FTA, with the expansion of trade, investment, and concrete trade liberalization for goods, services, and investment. Coverage, level of liberalization, products, negotiation modality, and economic cooperation are to be determined. Informal meeting of the expert group may be held to exchange information on Rules of Origin.
- (4) As ASEAN and China have signed the agreement on trade in services under ASEAN-China FTA, and ASEAN and Japan have initiated the negotiation process, South Korea government has shown clear direction to complete the ASEAN - KOREA FTA as expeditiously as possible. With this view, some products might be liberalized before both parties reach finalized agreement on the formation of FTA.

#### **5.5 ASEAN – Korea FTA – Key Considerations**

- The Expert Group have noted the benefits of ASEAN - KOREA FTA for both parties. The two sides have close trade and investment linkages due to economic cooperation, complementarities, geographical proximity and cultural similarities. Therefore, the Experts Group recommended that both sides should enhance efforts to maximize their potential for trade and investment relations.

- According to the quantitative analysis by using Global Trade Analysis Project (GTAP) model, ASEAN-Korea FTA is likely to increase ASEAN's GDP by 0.1-1.5% and Korea's GDP by 0.05-0.6%. This reflects the possibility for trade expansion and economic gain for both sides.
- The reduction/elimination of tariff and non tariff barriers is necessary for further liberalization and integration of their markets.
- For impacts on industries, when considering both effects of trade liberalization and capital accumulation, Thailand's industries tend to expand moderately. However, if considering only the effects of trade liberalization, negative impacts are seen on Thailand's textile and apparels, chemical, transport equipment industries. These are the industries which do not gain competitive advantage through the use of local content. On the other hand, processed food and machinery of Thailand will experience growth. This is because processed food industry still has competitiveness and in the latter industry, Thailand functions as a distributor.
- The effects of AKFTA on each sector depends on science and technological advance of such sector. Therefore, less developed countries, such as Indonesia or Vietnam are affected quite considerably from trade liberalization. However, input factor, especially low-cost labor, will benefit those countries with limited technological level.
- It is obvious that most ASEAN countries (except Singapore), as well as South Korea, tend to place agricultural and fishery products in Sensitive Track.
- For other products, both sides agreed to develop tariff reduction framework for 80% of all products within 2010. It is obvious that South Korea would like to complete the negotiation as expeditiously as possible so as to retain its ASEAN market. This reflects that South Korea, China, and Japan are competitors. Each country aims at expanding its trade in goods, services, and investment in ASEAN market. This may be resulted by the fact that the three countries will gain similar benefits in similar industries, in terms of access to low-cost raw materials, changes in production base for primary or secondary tiers, or market expansion.

## **5.6 ASEAN Plus Three FTA**

ASEAN Plus Three cooperation, which is an important step for the development of East Asia Cooperation, has been initiated and operated through various levels of mechanisms. Key issues can be drawn as follows:

- (1) East Asia Cooperation has been initiated in 1997 and Joint Statement on East Asia Cooperation was issued in 1999. The Report of the East Asia Vision Group (EAVG) and the Report of the East Asia Study Group (EASG) were the 2 studies used as a framework for the development of ASEAN+3 cooperation.

- (2) Main mechanisms used to ensure cooperation in various areas are the meeting and coordination in several levels, i.e. ASEAN+3 summit, ministerial meeting, director-general meeting, and senior officer meeting. Areas of cooperation include, for instance, political and security, as well as health.
- (3) Much progress is seen in financial and economic cooperation. This is obvious when considering increasing trade value between ASEAN and Plus Three countries, as well as bilateral and sub-regional FTA negotiations which are progressing continuously in the region, e.g. ASEAN-China agreement on trade in goods. These FTAs will function as jigsaws to greater cooperation in a regional level.
- (4) 17 short-term measures and 9 medium-term and long-term measures recommended by EASG and approved in the 2002 ASEAN+3 summit can be illustrated as follows:
  - ASEAN+3 countries are committed to implement 17 short-term measures within 2007, which marks 10-year anniversary of ASEAN+3 cooperation
  - 4 short-term measure which have been implemented are:
    - East Asia Human Resource Development - ASEAN Plus Three Study Group on Facilitation and Promotion of Exchange of People and Human Resources Development has been conducted, with Japan as the coordinator.
    - Network of East Asia Think-tanks: NEAT – with China and Thailand as the coordinators
    - Establishment of East Asia Forum (EAF) – with South Korea and Malaysia as the coordinators
    - Establishment of East Asia Business Council: EABC – with Malaysia as the coordinator
  - For medium-term and long-term measures, in ASEAN+3 Economic Ministers Meeting (AEM+3) in Jakarta, Indonesia, 2004, the recommendation on the establishment of an expert group to conduct the feasibility study of EAFTA was approved.

## **5.7 ASEAN Plus Three FTA – Key Considerations**

For the possibility and key mechanisms, some important issues can be drawn as follows:

- The formation of East Asia Free Trade Area: EAFTA is the recommendation which many countries in the region are interested as it will make East Asia become the largest economy with almost 2 billion consumers and create an expansion in trade and investment in the region.
- EAFTA formation is a long-term process. Key milestones to EAFTA formation is ASEAN+3 cooperation. Currently, ASEAN+3 countries have initiated cooperation in many areas, e.g. economic, investment, IT, social and culture cooperation, and bilateral and ASEAN+1 FTA negotiations, in particular.

- These bilateral and sub-regional FTAs are operating in parallel with the effort in the formation of EAFTA. Conditions or modalities of these FTAs will also function as a framework for EAFTA.

On the other hand, the barriers to EAFTA can be summarized as follows:

- Generally, most ASEAN members have been implementing similar economic development policies, which reflect, to a large extent, competition within member countries. For example, foreign trade policy, foreign investment policy and service sector development policy. This may result from the following factors:
  - For foreign investment policy, most ASEAN members are competing to attract the same groups of foreign investors, particularly those coming from Japan, Taiwan, and South Korea, to invest in their countries. Moreover, ASEAN members are also promoting the same kind of industries, e.g. textile and apparels, electrical appliances, electronics and computer.
  - For foreign trade, most ASEAN members are also competing to export their (same) products to the same destinations, e.g. USA, Japan, or EU. In consequence, most ASEAN members try to promote their same kinds of exports and protect their own domestic markets from foreign penetration.
  - For service sectors, most ASEAN members, both the old and new members countries, are implementing the same kinds of strategies to promote their service sectors, i.e., tourism, logistics, health-care, and retail trade.
- In addition to the barriers mentioned above, there are also some weaknesses within ASEAN. For example,:
  - Loose structure of regional cooperation which is based on consensus and voluntary agreements
  - Divergences in culture, economic structure, level of economic development, language barriers, etc.
  - Lacking of legally binding statutes as ASEAN has the efficient statutes-based integration
  - No official judiciary to oversee dispute settlements
  - No information disclosure system which causes difficulty for the establishment of good governance
  - The implementation of the non-tariff barriers (NTBs) to protect their own domestic market
- In the case of +3 countries, Japan, China, and South Korea are becoming competitors in several fields, e.g. technological development, brand building, foreign business network, or energy supply.

## **6. Analysis of Economic Effects of EAFTA by GTAP Model**

### **Effects on macro-economic of ASEAN+3 countries**

The impacts of EAFTA on GDP of each country are different. However, in general, various sectors of each country gains benefit from trade liberalization. This shows that FTA will render global benefit to the region. For Thailand, in particular, food industry, chemical industry, and plastic industry are the biggest gainers.

According to the result, FTA will cause trade surplus and trade deficit in each sector of the countries. South Korea experiences the least effects of trade deficit, with only one sector falling into disadvantage position, namely petroleum sector. For Thailand, overall trade balance shows that it experiences trade surplus more than ASEAN and +3 countries. Food industry of Thailand is expected to see the largest sectoral trade advantage while jewelry and petroleum sectors are expected to experience the largest sectoral trade deficit.