

Desirable and Feasible Option for an East Asia FTA

A Report

by Joint Expert Group on EAFTA Phase II Study

June 7, 2009

Preface

In October 2001, the East Asia Vision Group (EAVG) recommended the establishment of an East Asian Free Trade Area (EAFTA) in a report to the leaders of ASEAN Plus Three (ASEAN+3). In November 2002, the East Asia Study Group also proposed the formation of an EAFTA. In 2004, ASEAN+3 Economic Ministers (AEM+3) decided to set up an expert group initiated by China to conduct a feasibility study on an EAFTA. The Joint Expert Group reported the outcome of the study to AEM+3 in August 2006.

At the 10th ASEAN+3 Summit in January 2007, the heads of state and governments regarded the EAFTA as a fruitful avenue of integration, and appreciated the outcome of the EAFTA feasibility study. As a subsequent measure, they also welcomed the proposal by the Republic of Korea to conduct a Phase II study involving an in-depth sectoral analysis of the EAFTA.

The members of the Joint Expert Group for the EAFTA Phase II Study have conducted the research on 1) trade in goods focusing on four sectors, namely, textile, automobile, electronics, and agriculture, 2) services and investment, 3) rules of origin, 4) trade and investment facilitation, and 5) cooperation issues. They would like to present this report to AEM+3 and ASEAN+3 Leaders. The study on the diverse plurilateral and bilateral FTAs concluded among the East Asian countries revealed both the needs for a region-wide FTA as well as remaining obstacles to forming an EAFTA.

Thus, the Joint Expert Group for EAFTA Phase II Study proposes a desirable and yet feasible way to achieve an EAFTA, which will produce tangible benefits by effectively enhancing intra-regional trade and production networks in East Asia. In this report, a special consideration was given to less developed countries in order to help them fully utilize the benefits of an EAFTA while alleviating their administrative burdens in the process of forming it.

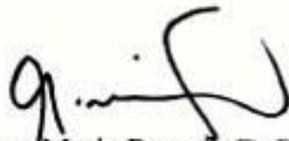
Chang Jae Lee

Chairman, Joint Expert Group for the EAFTA Phase II Study

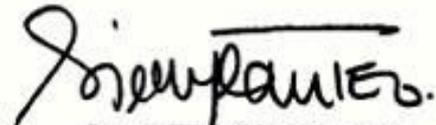
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Members of the Joint Expert Group for the EAFTA Phase II Study

In an alphabetical order of country



Anna Maria Rosario D. ROBENIOL
(ASEAN SECRETARIAT)



Joyce TEO Siew YEAN
(BRUNEI DARUSSALAM)



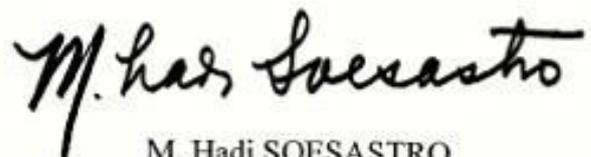
TAN Yuvarath
(CAMBODIA)



ZHANG Yunling
(CHINA)



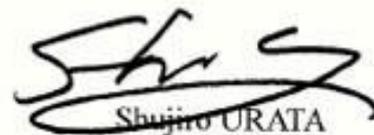
ZHAO Jianglin
(CHINA)



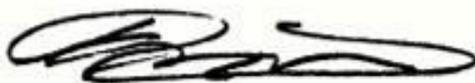
M. Hadi SOESASTRO
(INDONESIA)



Djisman S. SIMANDJUNTAK
(INDONESIA)



Shujiro URATA
(JAPAN)



Fukunari KIMURA
(JAPAN)



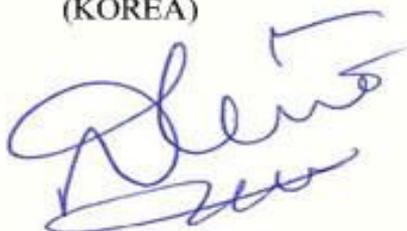
Chang Jae LEE
(KOREA)



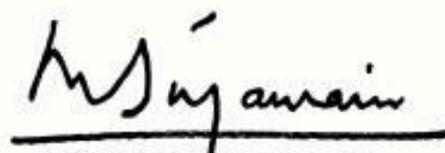
Hyung-Gon JEONG
(KOREA)



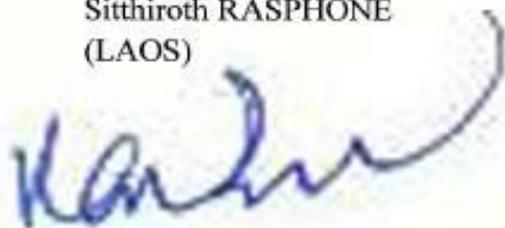
HanSung KIM
(KOREA)



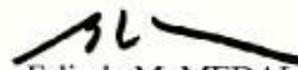
Sitthiroth RASPHONE
(LAOS)



M. SUPPERAMANIAM
(MALAYSIA)



Kan ZAW
(MYANMAR)



Erlinda M. MEDALLA
(The PHILIPPINES)



Shandre M. THANGAVELU
(SINGAPORE)



Suthiphand CHIRATHIVAT
(THAILAND)



BUI Truong Giang
(VIET NAM)

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Executive Summary

1. According to the Report by the Joint Expert Group submitted to the ASEAN+3 Economic Ministers Meeting (AEM+3 Meeting) in August 2006, the rationale for an East Asia FTA (EAFTA) lies firmly in both economic and political interests of all East Asian countries. An EAFTA would increase overall GDP of East Asian countries at least by 1.2 percent. More importantly, an EAFTA would increase awareness of a common destiny, institutionalize dialogues and contacts, and increase mutual understanding and cooperation.

2. Against the backdrop of the current global economic crisis coupled with a growing number of FTAs among East Asian countries, there is now a greater need to move towards an EAFTA. An EAFTA would help enhance the resilience of the East Asian regional economy against external shocks and sustain regional economic growth. It could also help overcome the problems caused by the proliferation of FTAs with differing rules of origin (ROOs) and overlapping agreements that have resulted in increasing transaction costs for intra-regional trade and raising production costs for production networks in East Asia. It is important to ensure that an EAFTA should be a building block towards the establishment of an open global trading environment.

3. In pursuing an optimal EAFTA that is high quality in terms of trade and investment liberalization, comprehensive facilitation and cooperation measures, we propose a gradual and realistic strategy.

4. The realization of an EAFTA could begin with the consolidation of the existing three ASEAN+1 FTAs as an important first step. This initial step should have the following three key characteristics. First, it should be desirable, producing additional tangible benefits by enhancing both intra-regional trade and production networks in East Asia. Second, it should be feasible politically and administratively. Third, it should be friendly to less developed countries. Special and focused efforts should be made to enable the less developed countries to effectively participate in and benefit from an

EAFTA.

5. In consolidating the existing three ASEAN+1 FTAs into a region-wide FTA, an important step is to create a unified ROO regime. With regard to liberalization of trade in goods, we propose the reduction of the element of discrimination arising from the implementation of multiple tariff concessions by, to the extent possible, harmonizing tariff commitments made in AFTA and the existing three ASEAN+1 FTAs.

6. Given the growing importance of services and investment in the region, in particular in the production network and value chain, the inclusion of agreements on trade in services and investment is important as they will bring greater economic benefits. Since two (AKFTA and ACFTA¹) of the three ASEAN+1 FTAs include agreements on trade in services and investment, ASEAN+3 countries have a good opportunity to establish a region-wide agreement. This is achievable in light of similarities in the structure of existing agreements on trade in services and investment involving ASEAN+3 countries.

7. Many trade and investment facilitation measures in the region are not regionally coordinated and often overlap each other. We propose to focus on concrete facilitation measures that could help all participating countries to fully realize the benefits of an EAFTA, particularly less developed countries. These could include ROO-related measures, customs procedures, and standards. Furthermore, specific cooperation programs should be directly linked to these facilitation measures to ensure their effective implementation. They should be supported by appropriate funding mechanisms and adequate resources. Facilitation and cooperation measures in an EAFTA will also help reduce development gaps in the region.

8. In moving towards an EAFTA, ASEAN's role is crucial in driving the process. It is equally important for China, Japan and Korea to assume a proactive role and engage in negotiations in line with the EAFTA process.

¹ The ASEAN-China Investment Agreement is scheduled to be signed in August 2009.

9. In order to face the new challenges deriving from the global economic crisis by enhancing both intra-regional trade and production networks in the region, East Asian leaders should put the EAFTA as an important initiative in the economic agenda during the 13th ASEAN+3 Summit in 2009. The process to form an EAFTA should immediately follow. We propose that this process begin with the creation of two working groups: one to design a unified regime of ROOs for the EAFTA, and the other to look into tariff nomenclature and other customs related issues.

10. The overall EAFTA negotiations should be launched at the latest by 2012.

Desirable and Feasible Option for an East Asia FTA

The 1997-98 Asian Financial Crisis inflicted severe pains to many East Asian countries. However, it also prompted East Asians to seriously consider economic regionalism, and gave birth to a regional economic cooperation entity, i.e., the ASEAN+3 framework.

Additionally, East Asian countries joined the worldwide FTA wave at the turn of the century, and have concluded many bilateral and plurilateral FTAs within a relatively short period of time. Yet, there is no region-wide FTA in East Asia.

At this juncture of East Asian economic integration where ASEAN Free Trade Area (AFTA) and the three ASEAN+1 FTAs, namely, ASEAN-China FTA (ACFTA), ASEAN-Korea FTA (AKFTA), and ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEP), were concluded, the most natural question would be whether an East Asia FTA (EAFTA) is still needed. Then, if an EAFTA is needed, the remaining key issue will be its feasibility.

A decade after the Asian Financial Crisis, East Asian countries are faced with the global economic crisis, whose impact on the East Asian economies might be greater given its scope and intensity. According to the International Monetary Fund (IMF),² the world output is expected to contract by 1.3 percent in 2009,³ and volumes of world trade in goods and services are expected to drop 11.0 percent. It is under these exceptional circumstances that this study seeks to highlight the needs for an EAFTA, and to suggest a concrete way to achieve it within the near future.

I. Needs, Obstacles, and Options for an EAFTA

II.1 Needs for an EAFTA

According to the Report by the Joint Expert Group submitted to the AEM+3 in August 2006, the rationale for an EAFTA lies firmly in both economic and political interests of

² IMF. 2009. *World Economic Outlook*, April.

³ According to the United Nations' forecast, the world economy is expected to shrink by 2.6 percent in 2009 (UN. 2009. *World Economic Situation and Prospects 2009: Update as of Mid-2009*, May).

all East Asian countries. Its economic benefits exceed those from any bilateral and sub-regional arrangements. At minimum, an EAFTA would increase overall Gross Domestic Product (GDP) of East Asian countries by 1.2 percent. In addition, an EAFTA would increase awareness of a common destiny, institutionalize dialogues and contacts, and increase mutual understanding and cooperation.

Its economic rationale seems evident considering the high level of economic dependency both in terms of trade and investment among East Asian countries. The share of intra-regional trade was 37.8 percent in 2007 among ASEAN+3 countries.⁴ It amounted to 39.8 percent in textile, 19.4 percent in automobile, 46.5 percent in electronics, and 36.8 percent in agriculture (see Table 1). The trade dependency of ASEAN countries on regional trading partners was particularly high (see Table 2). The increasing trends of production networks in East Asia testify also the need for a region-wide FTA.

Table 1. The Share of Intra-regional Trade among ASEAN+3 Countries

	(Unit: %)		
	1992	2000	2007
Total Economy	31.0	37.4	37.8
Agriculture	31.5	36.9	36.8
Automobile	13.3	15.1	19.4
Electronics	30.8	42.3	46.5
Textile	32.5	42.8	39.8

Notes: Agriculture (SITC 00~12), Automobile (SITC 78~79), Electronics (SITC 75~77), Textile (SITC 65); Some countries were excluded from the calculations of sectoral statistics since their trade data of products were not available (i.e., Brunei in 2000 and 2007, Cambodia in 1992 and 2007, Lao PDR in 1992, 2000, and 2007, Myanmar in 2000 and 2007, and Vietnam in 1992).

Sources: Calculated from UN COMTRADE database and IMF's Direction of Trade Statistics database.

Table 2. The Share of Intra-regional Trade for ASEAN+3 Countries

	(Unit: %)		
	1992	2000	2007
Brunei	78.3	74.1	64.4
Cambodia	84.8	35.8	50.0
Indonesia	49.1	50.6	55.8
Lao PDR	76.4	72.8	79.5
Malaysia	50.3	49.4	51.0
Myanmar	64.9	62.2	76.9
Philippines	32.5	39.7	47.0
Singapore	40.7	46.5	49.9

⁴ 46.0 percent, including Hong Kong and Taiwan. Calculated from IMF's Direction of Trade Statistics database and Taiwan's Bureau of Foreign Trade website.

Thailand	42.8	44.9	49.1
Vietnam	51.0	56.4	52.5
China	23.6	33.1	27.5
Japan	23.1	30.8	36.9
Korea	33.4	36.6	41.0

Sources: IMF's Direction of Trade Statistics database.

Most importantly, the rationale for an EAFTA comes from the growing number of bilateral and plurilateral FTAs among East Asian countries. With differing rules of origin (ROOs) and tariff reduction/elimination schedules, these multitude of FTAs have already created a spaghetti bowl (or noodle bowl) phenomenon, increasing transaction costs for intra-regional trade and raising production costs for production networks in East Asia.

Furthermore, the new development in the wake of the global financial crisis provides an additional rationale. In fact, the trade volumes of East Asian countries declined significantly. During the fourth quarter of 2008, the exports from ASEAN+3 countries to the world decreased by 14.3 percent compared with the previous quarter, and 5.2 percent year-on-year, respectively. The declines were especially severe in some countries.⁵ Moreover, the world markets, those of the United States and the European Union (EU), in particular, are not likely to recover in the near future. In order to compensate those contracted markets, East Asian countries need to increase the trade volume within the region. Thus, an EAFTA would help enhance the resilience of the East Asian regional economy against external shocks and sustain regional economic growth.

II.2 Obstacles to an EAFTA

As in other FTAs, the main impediment to an EAFTA comes from the existence of sensitive sectors and products in East Asian countries. Our analysis on the competitiveness using trade indexes and review on the tariff concession structure of existing intra-regional FTAs revealed that each country would have many sensitive sectors and products.

⁵ During the first quarter of 2009, China, Japan, Korea, and Singapore exports contracted 10.9 percent, 21.4 percent, 13.7 percent, and 8.6 percent from the fourth quarter of 2008, respectively, and 18.6 percent, 38.2 percent, 24.4 percent, and 31.2 percent year-on-year, respectively (Source: Global Insight. 2009. *World Overview*, May).

Thus, it will be politically burdensome for the governments of East Asian countries to embark on the formation of an EAFTA. These countries have just concluded important plurilateral and bilateral FTAs within a short period of time, and their economic benefits are yet to be materialized. In addition, for some countries, there are other ongoing FTA negotiations to cope with. So, the governments are also under administrative strains. In fact, many East Asian countries seem to experience a certain FTA fatigue.

On top of that, given the existing three ASEAN+1 FTAs, what will be the additional benefits of an EAFTA, and what kind of an EAFTA will be available? Those points do not seem to be clear for most East Asian politicians, government officials, and general public.

Furthermore, there is still no FTA between the three Northeast Asian countries, namely China, Japan, and Korea, where the biggest trade flows take place in the region. Evidently, an EAFTA could not be realized without a de facto bilateral FTA between these Northeast Asian countries.

II.3 Options for an EAFTA

An optimal EAFTA would need to have the following elements, 1) high quality in terms of market access for goods and services, 2) global standard investment agreement, 3) comprehensive and concrete trade/investment facilitation measures, 4) cooperation measures for less developed countries, 5) simple and liberal ROOs with full cumulation, and 6) an organized plurilateral FTA with common modalities and a dispute-settlement body rather than the sum of 78 bilateral FTAs.

It should be negotiated among 13 member countries using the existing three ASEAN+1 FTAs as a reference. Viewed from the number of members and their diversity, it will take a long time to achieve it, and it will not be easy to even launch the process of such region-wide FTA without a strong political leadership.

However, without a region-wide FTA, the continuing proliferation of FTAs will impair the intra-regional trade and production networks in East Asia. Therefore, we would like to propose a gradual strategy to achieve a region-wide FTA in East Asia starting from a realistic EAFTA first and continuing to improve the agreement until it becomes an optimal one.

The realization of an EAFTA could begin with the consolidation of the existing three ASEAN+1 FTAs as an important first step. This initial step should have the following three key characteristics. First, it should be desirable, producing additional tangible benefits by enhancing both intra-regional trade and production networks in East Asia. Second, it should be feasible, demanding minimum political and administrative burdens to the governments of East Asian countries. Third, it should be friendly to less developed countries. Special and focused efforts should be made to enable the less developed countries to effectively participate in and benefit from an EAFTA.

In our view, in order to facilitate effectively intra-regional trade and production networks in East Asia, the most important task will be the creation of a region-wide FTA with simple and liberal ROOs. The growing web of FTAs with differing ROOs constitutes a major impediment to liberal trade and investment flows within the region. In addition, in order to help less developed countries to cope with FTA related issues including ROOs, concrete trade and investment facilitation measures should be adopted with appropriate funding mechanisms.

On the other hand, in regards to liberalization of trade in goods and services, in order to minimize the political and administrative burdens, we propose utilizing the existing FTAs to a maximum degree. In other words, instead of renegotiating tariff elimination schedules and service liberalization from scratch, we propose to consolidate the existing four plurilateral FTAs, namely, AFTA, ACFTA, AKFTA, and AJCEP. Of course, since there is no bilateral FTA between China, Japan and Korea, full negotiations should be done among themselves.

In moving towards an EAFTA, ASEAN's role is crucial in driving the process. It is equally important for China, Japan and Korea to assume a proactive role and engage in negotiations in line with the EAFTA process. Additionally, it is necessary to ensure that an EAFTA become a building block towards the establishment of an open global trading environment.

II. Rules of Origin

Though intended to facilitate trade, promote investment, and protect sensitive local

industries from “unfair competition,” in reality, preferential ROOs provisions in the current FTAs are overly complex and could impose unintended consequences for business.

II.1 Rules of Origin in Existing FTAs⁶

Our review on the ROOs in the three ASEAN+1 FTAs indicates that the general rules in these FTAs share more or less common provisions.⁷ However, their product specific rules are appearing to be quite different from each other in many items (see Table 3).

Table 3. ROOs in Three ASEAN+1 FTAs: Selected Products

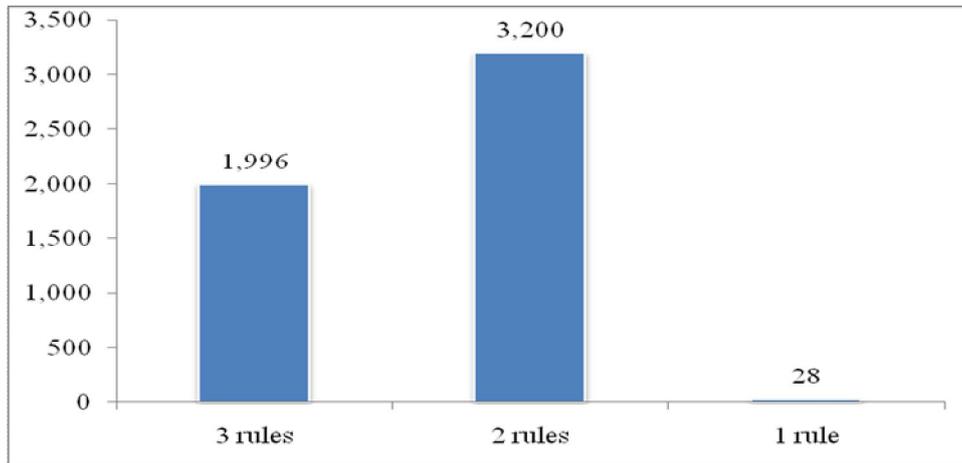
Sectors	Products (HS Code)	Agreements		
		ACFTA	AKFTA	AJCEP
Agriculture	Carcasses/half-carcasses of swine, frozen (HS0203.21)	40% RVC	Wholly-obtained or produced in the territory of the exporting party	CTC (2-digit)
Textile	Knitted or crocheted fabrics, n.e.s. (HS6006.33)	- Manufacture from: polymer (non-woven), fibers (fabrics), yarns (fabrics), raw or unbleached fabrics (finished fabrics) - Through substantial transformation process of either: needle punching/spin bonding/chemical bonding, weaving or knitting; crocheting or wadding or tufting; or dyeing or printing and finishing; or impregnation, coating, covering or lamination	40% RVC or CTC (4-digit)	CTC (2-digit), provided that, where non-originating materials are spun or dyed or printed entirely in one or more of the parties; or no required CTC, provided that the good is dyed or printed entirely and that the non-originating material of chapter 60 is knitted or crocheted entirely in one or more of the parties.
Electronics	Fuses (HS 8536.10)	40% RVC	45% RVC or CTC (6-digit)	40% RVC or CTC (4-digit)
Automobile	Motor cars (1,000~1,500cc)	40% RVC	45% RVC	40% RVC

⁶ Since the ROOs of the ACFTA is basically identical to the AFTA ROOs, we compared the ROOs of the three ASEAN+1 FTAs.

⁷ See Annex Table 1.

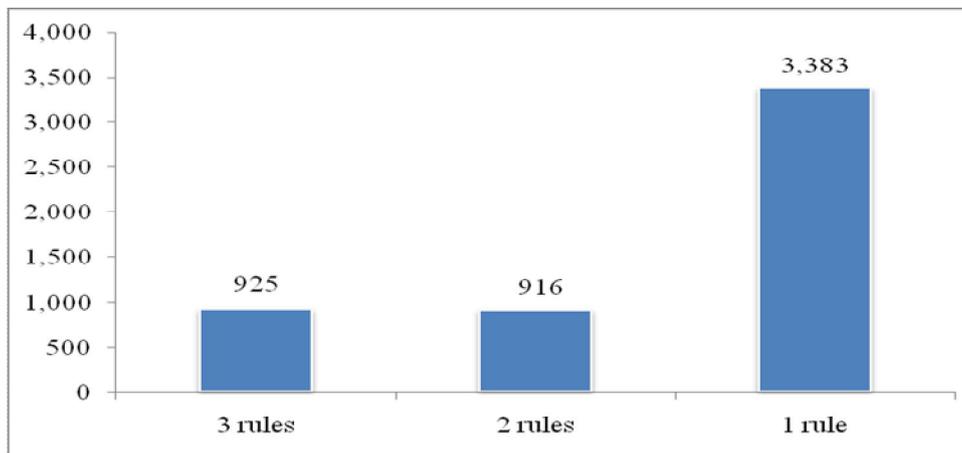
Notes: HS=Harmonized System; RVC=Regional Value Content; CTC=Change in Tariff Classification.
Sources: Official texts of ACFTA, AKFTA and AJCEP.

Figure 1. Number of Rules on All Items in ASEAN+1 FTAs



Sources: Official texts of ACFTA, AKFTA and AJCEP.

Figure 2. Number of Rules on All Items in ASEAN+1 FTAs:
Regarding co-equal rules as the same as their components



Sources: Official texts of ACFTA, AKFTA, and AJCEP.

Sectorally, for the three ASEAN+1 FTAs, we can note that the rules differ more in agricultural and textile industries, and that they are quite similar in electronics. In the agricultural sector, almost all primary products (97.5 percent) and about a third of processed primary products (33.9 percent) have 3 different rules, whereas in the textile industry, about one half of products have 3 different rules and the other half have 2 rules.

On the other hand, almost all electronic products share a single rule in the three FTAs, while two thirds of automobile products share a single rule (see Annex Table 2).

With respect to documentation and certification methods of ROOs, all three ASEAN+1 FTAs require Certificate of Origin issued by a government authority of the exporting countries. However, the specific administrative procedures and requirements for verifying ROOs are not consistent and tend to be cumbersome, which likely to further increase burdens on member countries, especially where customs mechanisms are poorly developed.

II.2 Expected Benefits from the Consolidation of Rules of Origin

It is reported that the utilization rates of the AFTA are low.⁸ Many reasons exist for this such as unilateral trade liberalization over the past two decades, and low preference margins, other than ROOs. Still, the cost of compliance with AFTA ROOs is also a major deterrent for the use of Common Effective Preferential Tariff (CEPT). The process for administering the ROOs seems extremely cumbersome to companies. Additionally, although the AFTA ROOs are simple, in practice, meeting 40 percent value added (VA) rule is often difficult, especially for the low wage CLMV countries.

The situation becomes worse with the conclusion of the three ASEAN+1 FTAs. The differing ROOs will result in further increasing business transaction costs, complicating customs procedures, and limiting the use of these FTAs. In particular, small and medium enterprises (SMEs) and exporters of less developed countries will be burdened by such high compliance costs.

If an EAFTA is formed with a unified ROO regime, it will produce the following benefits:

- 1) It will reduce transaction costs for ASEAN exporters and alleviate burdens for customs officials because there will be only one set of harmonized ROOs for all East Asian countries instead of three. Thus, more firms will be able to benefit from the EAFTA preferential rates than those of AFTA or the three ASEAN+3 FTAs. We could further reduce the compliance costs by making EAFTA ROOs more simple and liberal and by improving its administrative process.

⁸ Estimates of preference utilization rates based on firm interviews conducted for the ASEAN Secretariat show a utilization rate of about 5 percent of total trade (The World Bank. *Preferential Rules of Origin*, Trade Issues in East Asia, Policy Research, June 2007).

- 2) A unified EAFTA ROO regime with full cumulation will help foster deeper integration and the spread of regional production networks based upon freedom of sourcing of inputs throughout East Asia. In order for East Asia to be the factory of the world, it is important to create the environment where the regionally based firms are able to source from the most efficient sources in the world at world prices. In addition, it would make it much easier for low income countries to meet 40 percent VA rule, allowing them the greatest flexibility in terms of sourcing inputs.

II.3 Option for an EAFTA

Although we recommended a gradual approach to achieve an EAFTA, when it comes to the ROO regime, we propose adopting from the beginning a top quality one that can effectively reduce the costs of doing business across the region and promote seamless trade and production. Towards this end, the ROO regime for an EAFTA should entail the following key features:

- More liberal ROOs [co-equal rules or a single, least restrictive rule, such as the Change in Tariff Classification method (CTC method) at 4 to 6-digit level];
- Restrictive ROOs targeted at sensitive products should be limited and replaced by longer phase-out periods of tariff elimination;
- Full cumulation, and roll-up (absorption) process;
- De minimis provision;
- Use of self-certification (balanced by some monitoring system);
- SME friendly (capacity building training);
- Greater harmonization of customs procedures and toward a Harmonized System of Customs Classification; and
- Adequate provisions to control potential abuse.

III. Trade in Goods

III.1 Comparison between AFTA and the Three ASEAN+1 FTAs

AFTA, ACFTA, and AKFTA share basically the same tariff concession structure with the Normal Track (or Inclusion List) and the Sensitive Track, even though the details differ among them. However, the AJCEP has the item-by-item approach, which sets

tariff elimination or reduction schedules for each tariff item.⁹

In terms of tariff reduction/elimination modality, the AFTA-type FTAs look more plurilateral, while the AJCEP appears to be the sum of bilateral FTAs between Japan and ASEAN countries. For instance, both China and Korea belong to the same group as ASEAN-6 with regard to tariff reduction/elimination schedules as conditions, in their respective FTAs with ASEAN, while the CLMV countries constitute the other group(s).

Additionally, the AFTA-type FTAs have an advantage of providing each country with some flexibility to set its own tariff reduction/elimination schedules. On the other hand, AJCEP has a definite advantage of providing clearer tariff reduction/elimination schedules.

Furthermore, the tariff reduction/elimination schedules for the same product differ one from another in the three ASEAN+1 FTAs, and in some cases, quite significantly. Table 4 shows concrete examples of such situation, providing different tariff schedules of some selected items in the perspective of Malaysian importers.

Table 4. Tariff Elimination Schedules for Three ASEAN+1 FTAs:
Selected Products for Malaysia

Industries	Products	ACFTA	AKFTA	AJCEP
Agriculture	Carcasses and half-carcasses (HS 0203.11.000)	0%	Tariff rate quotas	Excluded
	Hens' eggs (HS 0407.00.910)	Tariff reduction ($< 50\%$)	Tariff rate quotas	Excluded
Textile	Ramie, linen or silk (HS 6205.90.000)	0~5% (by 2012)	0~5% (by 2016)	0%
	Other: sports footwear (HS 6402.19.000)	0%	0~5% (by 2016)	0% (8 years)
Electronics	Other apparatus for protecting electrical circuits: for use with electric fans (HS 8536.30.300)	0%	0~5% (by 2016)	0% (8 years)
	Co-axial cable and other co- axial electric conductors: Natural or synthetic rubber insulated (HS 8544.20.200)	0%	0~5% (by 2017)	5% (11 years)
Automobile	Motor-homes (HS 8703.32.400)	0%	20% reduction (by 2016)	0% (8 years)

⁹ In the AJCEP, Cambodia, Lao PDR, and Myanmar have slightly mixed tariff concession structures.

	Suspension shock-absorbers (HS 8708.80.100)	0%	0~5% (by 2016)	0% (6 years)
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Sources: Official texts of ACFTA, AKFTA, and AJCEP.

It is even more complex for ASEAN exporters to compare tariffs in China, Japan, and Korea because three countries use different tariff classification systems: China uses HS 8-digit, Japan uses HS 9-digit, and Korea uses HS 10-digit. Furthermore, ASEAN countries also use different variations of Harmonized System: for instance, Cambodia uses HS 6-digit, Thailand uses HS 7-digit, Vietnam uses HS 8-digit, Malaysia countries uses HS 9-digit, and Indonesia uses HS 10-digit. Consequently, the same product often has different HS codes in East Asian countries, which certainly adds transaction costs for intra-regional trade in East Asia.

III.2 Options for an EAFTA

Given the diversity of participating countries in terms of economic development levels, asymmetrical situations in trade liberalization in goods among partner countries seem to be unavoidable. Nevertheless, for an optimal EAFTA, the tariff elimination schedules should be much more liberal than the existing AFTA and ASEAN+1 FTAs with shorter phase-out periods and minimum number of exceptions.

To form an optimal EAFTA, East Asian countries must first agree on the basic format of the tariff concession structure, then, on the basis of it, all 13 countries should renegotiate tariff elimination schedules using the existing FTAs as a reference.

However, in order to lessen additional political and administrative burdens, we recommend that the existing tariff concession structures in AFTA and the three ASEAN+1 FTAs be basically used in an initial EAFTA. First, some harmonization of tariff reduction/elimination modalities and modifications related to the changes of ROOs will be needed. In addition, we propose the reduction of the element of discrimination arising from the implementation of multiple tariff concessions by, to the extent possible, harmonizing tariff commitments made in AFTA and the existing three ASEAN+1 FTAs. Thus, major multiple renegotiations among individual countries on tariff concession will not be necessary for the ASEAN members.

In fact, even without further liberalization in terms of tariff, an EAFTA with a more liberal ROO regime, and encompassing all ASEAN+3 economies will certainly bring

additional de facto liberalization of trade in goods.

Of course, the negotiations on tariff concession will be necessary between China, Japan, and Korea, should no FTA be concluded between them prior to the EAFTA negotiations. In that case, it is meaningful to note that a series of negotiations on tariff concession between the three countries would be conducted using the EAFTA ROO regime.

Finally, we strongly recommend the ASEAN+3 countries that they harmonize differing tariff classification systems among them before launching the EAFTA negotiations.

IV. Services and Investment

IV.1 Services

IV.1.1 Comparison between AFAS and Three ASEAN+1 FTAs

ACFTA and AKFTA largely follow the General Agreement on Trade in Services (GATS) format. As for the structure, ACFTA presents some modest GATS+ while AKFTA is almost equivalent to GATS. An interesting addition to GATS in ACFTA and AKFTA is on counter measures against cyber-terrorism in security exceptions. It should also be noted that ACFTA includes schedule of commitments and progressive liberalization beyond GATS. Both ACFTA and AKFTA have specific articles on cooperation and increasing participation by ASEAN latecomers.

The structure of agreements is different between ACFTA/AKFTA and Japan-Indonesia EPA (JIEPA).¹⁰ However, most of the key articles are common; in particular, for market access and national treatment, the three agreements apply the positive-list approach.¹¹

Salient differences between ACFTA/AKFTA and JIEPA are found in the following three points, though the convergence does not seem to be very difficult. First, neither ACFTA nor AKFTA includes an article on most favored nation (MFN), while JIEPA has one with an extensive negative list (MFN for finance and construction by Indonesia). Second, ACFTA and AKFTA are GATS equivalent on transparency, while JIEPA

¹⁰ AJCEP does not have meaningful articles on services. However, bilateral FTAs between Japan and ASEAN member countries include services chapters. As an example of them, the JIEPA is used.

¹¹ The Korea-Singapore FTA adopted the negative list approach.

includes more specific requirements. Third, there is no standstill in ACFTA and AKFTA, while JIEPA includes one for specified areas.

AFAS has a widely different structure. It seems difficult to directly link AFAS and ASEAN+1 FTAs.

As shown in Table 5, AKFTA has a bit more advanced liberalization than ACFTA though many are left as GATS equivalent. For ACFTA, only Singapore and Malaysia were active in liberalizing some subsectors belonging to several services. For, AKFTA, Singapore, Korea, Malaysia, and Indonesia liberalized some subsectors belonging to several sectors. Among CLMV countries, it is interesting to note that newly committed subsectors could be found only in Myanmar for both ACFTA and AKFTA.

Table 5. Features of Commitments for Service in FTAs among ASEAN+3 Countries

FTA/EP	Countries	Maintenance /Repair & Rental/Leasing Services	Computer & Related Services	Distribution Services	Financial Services	Communication Services	Transport Services
ACFTA	Brunei						Δ
	Indonesia						
	Malaysia		Δ		Δ	Δ	Δ
	Philippines					Δ	
	Singapore	Δ		Δ	Δ		Δ
	Thailand						Δ
	Cambodia						
	Laos				Δ		
	Myanmar				Δ	Δ	Δ
	Vietnam						
	China			Δ			Δ
	AKFTA	Brunei					Δ
Indonesia		Δ	Δ		Δ	Δ	Δ
Malaysia			Δ	Δ	Δ	Δ	Δ
Philippines					Δ	Δ	Δ
Singapore		Δ	Δ	Δ	Δ		Δ
Thailand							
Cambodia							
Laos					Δ		
Myanmar					Δ	Δ	Δ
Vietnam							
Korea				Δ		Δ	Δ
* JI	Indonesia	Δ	Δ	Δ	Δ	Δ	Δ

Notes: Δ means that the country commits to partially liberalizing the concerned sector; and * JI indicates Japan-Indonesia EPA.

Sources: Official texts of ACFTA, AKFTA, and JIEPA.

JIEPA has much deeper commitments than ACFTA/AKFTA equivalent. For the JIEPA, Indonesia committed quite a few subsectors belonging to several services (see Table 5).

IV.1.2 Options for an EAFTA

Compared to trade in goods, trade in services lag far behind in terms of liberalization. There is still ample room for expansion of the coverage for AFAS, ACFTA, AKFTA, and AJCEP, and for many countries, no meaningful service liberalization has been achieved.

Thus, if we seek a path of convergence across ASEAN+1 FTAs, specific commitments in services trade should be one of the focal points in negotiations. An optimal EAFTA should be the one with much more comprehensive coverage of services containing many GATS+ commitments, adopting the negative list approach.

However, given the development levels of service sectors in many East Asian countries, it would not be easy to renegotiate for a high quality EAFTA in terms of service liberalization. Thus, the easiest option might be to consolidate the existing FTAs without attempting to further liberalize the service sectors. Nevertheless, considering relatively low level of service liberalization in the existing FTAs, we propose that East Asian countries seek to liberalize service sectors to the extent possible, especially in the area of production related services, because they will not be able to raise their economic competitiveness without having efficient service sectors.

IV.2 Investment

IV.2.1 Current Status

Unlike the case of trade in goods, not all agreements on investment have yet been concluded for ASEAN+1 frameworks. The ASEAN-Korea Investment Agreement (AKIA) was signed on June 2, 2009, and the ASEAN-China Investment Agreement is scheduled to be signed in August 2009, while an ASEAN-Japan Investment Agreement has yet to be established.

Because of this reason, the cases for the assessment of the rules on investments are limited. Specifically, Table 6 compares the elements of three available investment

related agreements, namely, ASEAN Comprehensive Investment Area (ACIA), Japan-Korea Bilateral Investment Treaty (JKBIT), and Investment Chapter in Japan-Singapore EPA (JSEPA).

Table 6. Element of Investment Agreement and Investment Chapter in FTAs

		ACIA	JKBIT	JSEPA	
Liberalization of Investment	National Treatment (pre-establishment)	○	○	○	
	Most-Favoured-Nation Treatment (pre-establishment)	○	○	×	
	Prohibition of Performance Requirement(PR)	○	○	○	
	○=Absolutely prohibited ●=Permitted if required as a condition for granting interest X=no mention	Export requirement	×	○	○
		Local content requirement	○	○	○
		Local procurement requirement	○	○	○
		Export and import balance requirement	○	○	○
		Domestic sale restriction requirement	×	○	○
		Technology transfer requirement	×	●	●
		Head office establishment requirement	×	●	●
		Research and development requirement	×	●	●
		Specific region supply requirement	×	●	●
		Local citizen employment requirement	×	●	×
	Officers' nationality requirement	×	×	○	
Reservations	Negative	Negative	Negative		
Facilitation of Investment Activities	Entry, Temporary Stay and Work of Investors and Key Personnel	○	○	○	
	Transparency	○	○	○	
Protection of Investors	National Treatment (post establishment)	○	○	○	
	Most-Favoured-Nation Treatment (post establishment)	○	○	○	
	Treatment of Investment	○	○	○	
	Umbrella Clause	×	×	×	
	Expropriation and Compensation	○	○	○	
	Compensation in Cases of Strife	○	○	○	
	Transfers	○	○	○	
	Subrogation	○	○	○	
	Investment Dispute Between an Investor and a Member State	○	○	○	
Disputes Between or Among Member States	○	○	○		

Notes: Except for the case of performance requirement, O indicates the presence of provision concerning the item and X indicates otherwise.

Sources: Ministry of Economy, Trade and Industry, and the Japanese Government.

Broad similarities in the contents of investment rules are observed among those listed in Table 6. National treatment is provided in all three frameworks, while reservations for

market access (the right of establishment) are specified in the form of negative list. Items in the facilitation of investment activities as well as those under the protection of investors are exactly the same for all three frameworks.

Having noted this, many agreements prohibit export requirement, local content requirement, local procurement requirement, and export and import balance requirement. The major reason for prohibiting these requirements is the Agreement on the Trade Related Investment Measures under the World Trade Organization (WTO), which prohibits local content requirement, local procurement requirement, and export and import balance requirement.

As for the AKIA, it includes provisions related to facilitation and protection of investment, as well as liberalization provisions.¹² However, ASEAN and Korea agreed to progressively liberalize the investment regime by completing the discussion on the schedules of reservation within five years from the date of entry into force of the Agreement.

It should also be mentioned that the sectors in which foreign investment is restricted differ greatly among the ASEAN+3 countries, as shown in Table 7. These differences in the restricted sectors among ASEAN+3 countries have to be dealt with in order to establish a free investment environment.

Table 7. The Number of Sectors under Restriction on Foreign Ownership

Country	Number of restricted sectors
Brunei	18
Cambodia	23
Indonesia	15
Lao PDR	29
Malaysia	59
Myanmar	23
Philippines	50
Singapore	10
Thailand	63
Vietnam	45
China	40
Japan	12
Korea	21

Sources: Country sources.

¹² Liberalization provisions will be effective after completing the discussion on the schedules of reservation.

IV.2.2 Option for an EAFTA

Given the growing importance of investment in the region, in particular in the production network and value chain, the inclusion of agreement on investment is important as it will bring greater economic benefits. Since two (AKFTA and ACFTA¹³) of the three ASEAN+1 FTAs include agreement on investment, ASEAN+3 countries have a good opportunity to establish a region-wide agreement. This is achievable in light of similarities in the structure of existing agreements on investment involving ASEAN+3 countries.

However, since the investment environment differs quite significantly among the ASEAN+3 countries, as indicated by Table 7, ASEAN+3 members may adopt a phase-in approach by pursuing gradual liberalization, *à la* AFTA.

V. Trade and Investment Facilitation

V.1 Current Status

Trade and investment facilitation (TIF) and its benefits to the regional economy as well as to an individual country have lately been the subject of considerable attention in East Asian countries. Accordingly, many TIF measures and actions have been addressed at multiple levels among East Asian countries.

Asia-Pacific Economic Cooperation (APEC), first of all, has highlighted the importance of TIF since the mid-1990s. It has set a quantitative goal¹⁴ of reducing transaction costs, and proposed a series of actions and measures in the forms of Trade Facilitation Action Plans (TFAP) I and II. The ASEAN's approach of TIF is based on various frameworks of declarations and agreements that aim at creating a single market. At the ASEAN+3 level, a numbers of TIF measures are addressed in the "ASEAN plus Three Cooperation

¹³ The ASEAN-China Investment Agreement is scheduled to be signed in August 2009.

¹⁴ The APEC Leaders agreed to reduce cross-border trade transaction costs by 5 percent between 2002-2006 as a result of the Shanghai Summit in 2001. Following to that, the Leaders adopted Busan Roadmaps in 2005, which call for a further reduction of those costs by 5 percent by 2010.

Work Plans 2007-2017.”¹⁵ Lastly, the Greater Mekong Sub-region (GMS) project also developed a formal strategic framework for TIF, which covers a wider range of areas such as trade infrastructure and logistics.

Although all concluded FTAs in East Asia, including both bilateral and ASEAN+1 FTAs, do not mention the term “trade and investment facilitation,” they contain some provisions related to TIF. As seen in Table 8, all agreements deal with customs procedures and standards and conformance aiming at the simplification and harmonization of all relevant procedures and regulations. Some bilateral agreements further expand their scopes including the provisions on paperless trade and e-commerce, and movement of natural persons.

Table 8. TIF related Provisions in the Concluded FTAs in East Asia

TIF related Provisions	JM EPA	JV EPA	JS EPA	JP EPA	JT EPA	JI EPA	KS FTA	AC FTA	AK FTA	AJ CEP
Customs Procedures	O	O	O	O	O	O	O	O	O	O
Standards & Conformance	O	O	O	O	O	O	O	O	O	O
Sanitary & Phytosanitary Measures	O	O							O	O
Movement of Natural Persons	O	O	O	O	O	O	O			
Paperless Trading / E-commerce			O	O	O		O			

Sources: Official texts of the concerned FTAs.

Although there exist various TIF measures and actions in the region, which try to reflect the basic principles of TIF, including simplifying customs procedures, promoting transparency, and on alignment with international standards, their efforts have remained to be rather general or an aspiration.¹⁶ Many TIF measures in the region are not

¹⁵ It has been formulated as the master plan for the “Second Joint Statement on East Asia Cooperation Building in the Foundations of ASEAN Plus Three Cooperation,” which was adopted at the ASEAN+3 Summit in 2007.

¹⁶ It should be noted that ASEAN has made significant progress with regard to customs procedures. For example, in 2003, ASEAN adopted “ASEAN Customs Valuation Implementation Guide” which was developed on the basis of the WTO Agreement on Customs Valuation. In addition, most of ASEAN countries have implemented the ASEAN Harmonized Tariff Nomenclature (AHTN) and procedure for

regionally coordinated and often overlap each other. In addition, these measures are often at different stages of implementation without a specific time frame.

V.2 Options for an EAFTA

An optimal EAFTA would consolidate all TIF activities that are addressed in the existing agreements and action plans with more concrete and binding measures, not just being an aspiration or suggesting possible TIF measures.

To be realistic, however, we recommend that an EAFTA should limit the coverage of TIF focusing on measures related to ROOs, customs procedures, and standards. Indeed, those measures need to be specific, binding, and enforceable ones that could help all participating countries to fully realize the benefits of an EAFTA, especially less developed countries. In particular, as mentioned earlier, it is important to harmonize differing tariff classification systems among ASEAN+3 countries.

In addition, it is necessary to provide resource and technical assistance to the less developed countries so they can successfully implement any proposed TIF (i.e. offering support in building any computerized customs related databases or organizing training courses to enable customs officials to implement harmonized customs procedures and ROOs), and this will eventually contribute to narrow the development gap among members.

VI. Cooperation

VI.1 Current Status

For the efforts to narrow the development gap among East Asian countries, myriad development cooperation projects have either been implemented or are being carried out or have been agreed upon. Their sector coverage ranges from agriculture and

Post-clearance Audit (PCA).

environment to information and communication technology, and a series of actions and plans have been designed to be implemented. The spatial and sectoral distribution of development cooperation in East Asia appears to be too widespread to produce meaningful effects on a lasting basis (see Annex Table 3).

Table 9. Areas for Cooperation in ASEAN+1 FTAs

Category	Areas for Cooperation	ACFTA	AJEPa	AKFTA
Trade and Investment	Customs procedures	○		○
	Trade		○	○
	Investment	○	○	○
	Information and communication technology	○	○	○
	Standards and conformity assessment			○
	Sanitary and phytosanitary measures			○
	Shipbuilding and maritime transport	○	○	○
Industrial Cooperation	Tourism	○	○	○
	Financial services	○		○
	Agriculture, fisheries, livestock, plantation commodities, and forestry	○	○	○
	Environmental industry	○	○	○
	Broadcasting			○
	Mining	○		○
	Energy	○	○	○
	Natural resources			○
	Film			○
	Industrial cooperation	○		
	Biotechnology	○		
	Construction technology			○
Industrial Competitiveness	Small and medium-sized enterprises	○	○	○
	Human resource management and development	○	○	○
	Science and technology			○
Regional Development	Sub-region development	○		○
Others	Intellectual property rights	○	○	○
	Competitive policies		○	

Sources: Official texts of the concerned FTAs.

Although development cooperation or economic development provisions are not usually included in typical FTAs, three ASEAN+1 FTAs contain such provisions¹⁷ and propose

¹⁷ACFTA: Article 7, Part 2 “Other Areas of Economic Cooperation;” AJCEP: Chapter 8, “Economic Cooperation,” and Annex 5 “Work Programme for Economic Cooperation;” AKFTA: Chapter 3 and

various sectors and areas for cooperation (see Table 9). In addition, the agreements stipulate that the involved parties will carry out programs for technology assistance and capacity building for less developed members.

In particular, AJCEP includes a provision that commits to establish “Sub-committee on Economic Cooperation,” for the purpose of the effective implementation and operation of cooperation activities proposed in the Agreement. In addition to that, AJCEP stipulates that resources for the economic cooperation shall be provided, although neither a detailed amount nor procedure is proposed.

Just like TIF measures, many ongoing cooperation programs are also addressed in ASEAN+1 FTAs, and many of these programs and initiatives are overlapped and not implemented yet.

VI.2 Options for an EAFTA

Similar to the case of TIF, an optimal EAFTA would be comprehensive in scope including all the existing cooperation efforts in the region. At this stage, however, we recommend that specific cooperation programs should be directly linked to the TIF measures to ensure their effective implementation, which will enable less developed countries to fully utilize an EAFTA.

It is necessary to establish appropriate funding mechanisms along with adequate resources for the purpose of financing TIF measures. ASEAN+3 members have agreed to establish the ASEAN Plus Three Cooperation Fund¹⁸ in order to facilitate the implementation of ASEAN Plus Three Cooperation Work Plan. We can expand the amount of the concerned funds or newly create an economic cooperation fund in the EAFTA framework.

Annex, “Economic Cooperation.”

¹⁸ At the 12th ASEAN+3 Summit in 2007, the leaders endorsed that the initial amount of the Fund would be USD 3 million. Following to that, during the 9th ASEAN+3 Foreign Ministers Meeting in July 2007, it has been decided that China, Japan, and Korea would each contribute USD 900,000, and ASEAN would contribute USD 300,000.

VII. Major Recommendations

1. **We recommend that East Asian leaders should put the EAFTA as an important initiative in the economic agenda during the 13th ASEAN+3 Summit in 2009, and that the process to form an EAFTA should immediately follow.**
2. **We recommend to East Asian leaders that a gradual and realistic strategy be pursued to achieve a desirable and feasible EAFTA.** Faced with the global economic crisis and continuing proliferation of FTAs, it is desirable for East Asia to create a region-wide FTA with unified ROOs to effectively enhance intra-regional trade and production networks in the region. At the same time, the EAFTA should be feasible politically and administratively.
3. **We recommend that initially the EAFTA be formed by consolidating the existing FTAs (AFTA and three ASEAN+1 FTAs).** Towards this end, an important first step is to create a unified ROO regime. With regard to liberalization of trade in goods, we propose the reduction of the element of discrimination arising from the implementation of multiple tariff concessions by, to the extent possible, harmonizing tariff commitments made in AFTA and the existing three ASEAN+1 FTAs.
4. Since two (AKFTA and ACFTA) of the three ASEAN+1 FTAs include agreements on trade in services and investment, **we recommend that further work be undertaken to incorporate trade in services and investment in the EAFTA.**
5. **We recommend that concrete trade and investment facilitation measures be implemented to enable all participating countries, especially less developed countries, to fully realize the benefits of an EAFTA.** These could include ROO-related measures, customs procedures, and standards. Specific cooperation programs should be directly linked to these facilitation measures to

ensure their effective implementation. They should be supported by appropriate funding mechanisms and adequate resources.

- 6. To pave the way for an EAFTA, we recommend the immediate creation of two working groups: one to design a unified regime of ROOs for the EAFTA, and the other to look into tariff nomenclature and other customs related issues.**

- 7. We recommend that the overall EAFTA negotiations should be launched at the latest by 2012.**

Annex Table 1. Comparison of General Rules in Three ASEAN+1 FTAs

	Provisions	ACFTA	AKFTA	AJCEP
Basic Principles	Products wholly obtained/produced	O	O	O
	Non-qualifying operations	× ¹⁾	O	O
	Outward processing	×	O	×
	Direct transportation	O	O	O
Supplementary Principles	Accumulation	O	O	O
	De minimis	×	O ²⁾	O ³⁾
	Treatment of packing and packing material	O	O	O
	Accessories, spare parts, and tools	O	O	O
	Indirect materials/neutral elements	O	O	O
	Identical and interchangeable materials	×	O	O

Notes: 1) Instead, it stipulates minimal operations and processes.

2) For textile goods (HS50-63), less than 10 percent on the basis of weight; for all other goods, less than 10 percent on the basis of FOB.

3) Mostly the same as 2), but for certain goods under CH 18 and 21, less than 10 or 7 percent. Also, CH 16, 19, 20, 22, 23, 25, 26, and 27 are excluded.

Sources: Official texts of ACFTA, AKFTA, and AJCEP.

Annex Table 2. Product Specific Rules of Origin in ASEAN+1 FTAS

Industry	Number of Rules	Number of Products	%
Primary products (HS 01-10, HS 6 digit: 396)	3	386	97.5
	2	10	2.5
	1	0	0.0
Processed primary products (HS 11-24, HS 6 digit: 333)	3	113	33.9
	2	212	63.7
	1	8	2.4
Processed mineral products (HS 25-28, HS 6 digit: 334)	3	0	0.0
	2	1	0.3
	1	333	99.7
Chemical and rubber products (HS 29-40, HS 6 digit: 843)	3	0	0.0
	2	15	1.8
	1	828	98.2
Leather products (HS 41-43, HS 6 digit: 74)	3	0	0.0
	2	74	100.0
	1	0	0.0
Wood and paper products (HS 44-49, HS 6 digit: 234)	3	0	0.0
	2	74	31.6
	1	160	68.4
Textile and clothes (HS 50-67, HS 6 digit: 903)	3	423	46.8
	2	465	51.5
	1	15	1.7
Non-metallic mineral products (HS 68-741, HS 6 digit: 193)	3	3	1.6
	2	13	6.7
	1	177	91.7
Metal products (HS 72-83, HS 6 digit: 584)	3	0	0.0
	2	11	1.9
	1	573	98.1
General machinery (HS 84, HS 6 digit: 512)	3	0	0.0
	2	1	0.2
	1	511	99.8
Electrical machinery (HS 85, HS 6 digit: 287)	3	0	0.0
	2	3	1.0
	1	284	99.0
Transport equipment (Automobile) (HS 87, HS 6 digit: 76)	3	0	0.0
	2	25	32.9
	1	51	67.1
Other Transport Equipment (HS 86, 88-89, HS 6 digit: 58)	3	0	0.0
	2	0	0.0
	1	58	100.0
Precision machinery (HS 90-91, HS 6 digit: 216)	3	0	0.0
	2	0	0.0
	1	216	100.0
Other Manufacturing (HS 92-97, HS 6 digit: 181)	3	0	0.0
	2	12	6.6
	1	169	93.4
Total Number of Products (HS6)		5,224	0.0

Sources: Official texts of ACFTA, AKFTA, and AJCEP.

Annex Table 3. Regional and Sub-Regional Development Cooperation Programs

	Agri	Energy	Environ	HR	ICT	Transport	Tourism	Trade	Investment	Involved Countries
East Asia Cooperation Work Plan ¹⁾	○	○	○	○	○	○	○	○	○	ASEAN China, Japan, Korea
IAI ²⁾		○		○	○	○				ASEAN
GMS ³⁾	○	○	○	○	○	○	○	○	○	CLMV, Thailand, China
AMBDC ⁴⁾	○	○		○	○	○	○	○	○	ASEAN China
ACMECS ⁵⁾	○			○		○	○	○	○	CLMV, Thailand
BIMP-EAGA ⁶⁾	○						○			Brunei, Indonesia, Malaysia, Philippines
IMT-GT ⁷⁾		○		○	○	○	○	○	○	Indonesia, Thailand, Malaysia

Notes: 1) ASEAN Plus Three Cooperation Work Plan.

2) Initiative for ASEAN Integration.

3) Greater Mekong Subregion.

4) ASEAN-Mekong Basin Development Cooperation.

5) Ayeyawaddy-Chao Phraya-Mekong Economic Cooperation Strategy.

6) Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area.

7) Indonesia-Malaysia-Thailand Growth Triangle.

Sources: Official texts of each initiative or program.