

Towards an East Asia FTA: Modality and Road Map

A Report

by Joint Expert Group for Feasibility Study on EAFTA

July 22, 2006

Preface

During the 8th ASEAN+3 Summit in Vientiane, 29 November 2004, leaders “exchanged views on the establishment of an East Asia Free Trade Area (EAFTA) and welcomed the decision by the ASEAN+3 Economic Ministers to set up an expert group to conduct a feasibility study on EAFTA”. Chinese Premier Wen Jiabao announced that China would take initiative to launch the study and host the first expert group meeting.

A Joint Expert Group for Feasibility Study on EAFTA (JEG) was established and had its first meeting in April, 2005 in Beijing. JEG with its members coming from 13 East Asian countries works independently though it benefits from full support of the governments of all ASEAN+3 countries. Members of JEG have worked together for more than a year on the feasibility of EAFTA and finished this report *“Towards an East Asia FTA: Modality and Road Map”*.

We would like to present this report to ASEAN+3 economic ministers and ASEAN+3 leaders. As recommended, JEG hopes

East Asian leaders put EAFTA on the economic cooperation agenda in 2006 during the 10th ASEAN+3 Summit and an independent process to form an EAFTA could be launched in 2007 as one of the major initiatives in the Second Joint Statement on East Asian cooperation.

Zhang Yunling

A handwritten signature in black ink, appearing to read 'Zhang Yunling', written in a cursive style.

Chairman

Joint Expert Group for Feasibility Study on EAFTA

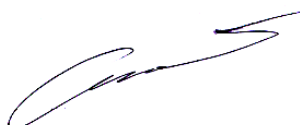
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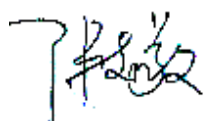
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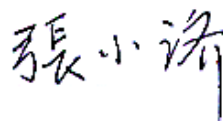
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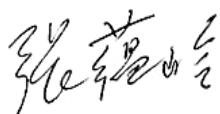
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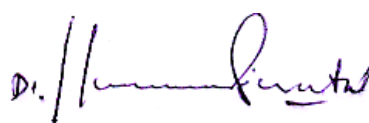
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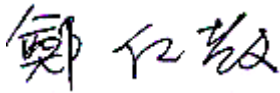
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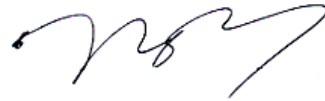
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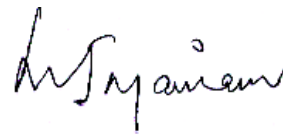
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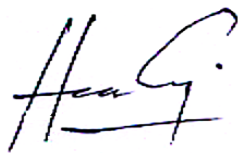
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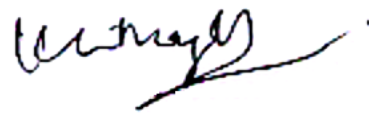
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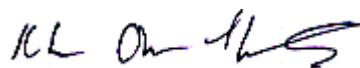
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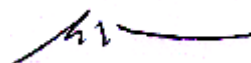
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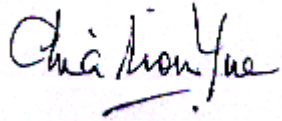
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Content

Executive Summary

I. The Rationale for an EAFTA

I.1. Rising Interest in FTAs

I.2 Rationale for an EAFTA

II . The Benefits of EAFTA

II. 1 Expected Benefits of EAFTA

II. 2 Simulation Results

III. Modality for an EAFTA

III. 1 Principles

III. 2 Elements of a Comprehensive Agreement

IV. Road Map to an EAFTA

IV. 1 Paths towards an EAFTA

IV. 2 Timing of an EAFTA

IV. 3 EAFTA Membership

IV. 4 Relations with Other FTAs

IV. 5 Approach and Related Issues

V. Major Recommendations

Executive Summary

- 1. East Asian cooperation under “ASEAN+3” has achieved noticeable progress. With the progress achieved, it naturally leads to a higher level of institution building. An East Asia FTA (EAFTA) would be a core part of this development.**
- 2. The rationale for EAFTA lies firmly in both economic and political interests of all East Asian countries. The economic benefits from EAFTA exceed those from AFTA, any ASEAN+1 FTA, or any other bilateral and sub-regional arrangement. An EAFTA would increase awareness of a common destiny, institutionalize dialogues and contacts and increase mutual understanding and cooperation.**
- 3. The initial conditions in East Asia form an important foundation for an EAFTA. As East Asian countries have been undergoing continuous trade and investment liberalization, an EAFTA with trade and investment as its core is highly desirable.**
- 4. The results of our simulation analysis show that East Asian countries will benefit from EAFTA, as they can**

expect an increase in both production and economic welfare. At minimum, EAFTA would increase overall GDP of East Asian countries by 1.2 percent and increase economic welfare by 104.6 billion US dollars.

- 5. East Asia should strive for a high quality FTA by being comprehensive in scope, removing trade and investment barriers, strengthening capacity and fostering open regionalism. It will lead to further deepening of economic integration, enhancing the competitiveness of production networks, and progressively reducing development gaps among East Asian countries.**
- 6. An EAFTA must be beneficial to all its members. Maximum economic benefits can be gained by being comprehensive in scope with substantial liberalization in all sectors. Comprehensiveness also implies that liberalization measures are complemented by facilitation and development cooperation efforts.**
- 7. To achieve a high quality FTA, it is important that EAFTA should be negotiated and implemented as a single package. An EAFTA should go beyond existing East Asian FTAs. Within the framework of a single package, a gradual and progressive approach should be adopted.**

- 8. An EAFTA is to be negotiated among ASEAN+3 countries first. In view of the recent expansion of FTAs, membership will be open to other East Asian economies, as well as other members of East Asia Summit.**
- 9. With a view to helping the less developed countries, economic development cooperation initiatives with specific action plans must be adopted as an integral component of the EAFTA.**
- 10. East Asian leaders should put EAFTA on the economic cooperation agenda in 2006 during the 10th ASEAN+3 Summit and an independent process to form an EAFTA could be launched in 2007 as one of the major initiatives in the Second Joint Statement on East Asian cooperation.**

Towards an East Asia FTA: Modality and Road Map

East Asian cooperation under “ASEAN+3” has achieved noticeable progress: an institutional framework for regional cooperation has been set up supported by annual Leaders’ Meetings, Ministers’ Meetings and Senior Officials’ Meetings, financial and monetary cooperation under Chiang Mai Initiative and sub-regional development projects (GMS), etc. With the progress achieved, it naturally leads to higher level institutional building. An East Asia FTA (EAFTA) would be a core part of this development.

During the 8th ASEAN+3 Summit in Vientiane, 29 November 2004, leaders “exchanged views on the establishment of an East Asia Free Trade Area (EAFTA) and welcomed the decision by the ASEAN+3 Economic Ministers to set up an expert group to conduct a feasibility study on EAFTA”. This shows that political will of East Asian countries for establishing EAFTA has been gradually built up.

I . The Rationale for an EAFTA

I.1. Rising Interest in FTAs

Free trade agreements (FTAs)¹ are a major feature of today's global trading landscape. The number of FTAs as well as their share of world trade has been rising, particularly in the post-1990 period. WTO data show that 193 FTAs have been notified to GATT/WTO and are in force as of early 2006. Almost all WTO members belong to one or more FTAs and multiple memberships are rising. Trade between FTA partners is estimated to exceed 50% of total global trade.

East Asia is well known for its regionalization from the early 1980s that underpins the East Asian economic miracle. Regionalization refers to the growing economic interdependence as a result of market-driven trade, investment and capital flows. These flows have been in response to several developments in East Asia -- increasing adoption of outward-looking trade, FDI and development strategies by the market economies in the Asian NIEs and ASEAN; market-oriented economic reforms and opening up of the transitional economies; realignment of exchange rates following the Plaza Accord of September 1985 and the consequent surge in outward investments from Japan and Asian NIEs to the rest of the region, creating a web of production networks.

With increasing economic interdependence, regionalism in East Asia also

¹ In this report, we use "FTA" to mean free trade agreement in broad terms that usually includes trade in goods and services, investment, economic cooperation and other contents based on agreement. The term "RTA" is also widely used for the similar meaning.

emerges. In 1992, ASEAN agreed to establish the ASEAN Free Trade Area (AFTA). The 1997 Asian financial crisis acted as a catalyst towards East Asian regionalism. The regional contagion of the crisis demonstrated the close economic and financial interdependence and interconnectivity among East Asian countries. This, and unease and unhappiness over the policies of the “Washington Consensus”, led to the ASEAN+3 initiative for regional cooperation.

The rise of the People’s Republic of China (China), and its WTO accession, has given an additional push to East Asian regionalism. Since WTO accession in December 2001, China is also showing growing interest in regional economic integration and FTA strategy.

By taking FTAs as the new strategies, Japan and the Republic of Korea (Korea) have shown their increasing interest in FTAs. Japan concluded the Economic Partnership Agreement (EPA) with Singapore in 2002. Japan and Korea started their negotiation on an FTA in 2003. Since 2001, China, Japan and Korea have continued their joint study on economic cooperation and a possible trilateral FTA.

FTAs are proliferating elsewhere. In Europe, the single market was established in 1992, and EU membership was extended to Austria,

Finland and Sweden in 1995, and to 10 Central and Eastern European countries in 2004. In the Western Hemisphere, NAFTA was established in 1994 and FTAA is being negotiated, linking 34 economies in North, Central and South America. East Asia had only AFTA formed in 1992. Apart from the geo-political implications of these continental blocs, East Asian exporters are being discriminated against in all these preferential markets, and ASEAN is also concerned over possible investment diversion to NAFTA and the expanded EU. Thus, FTA efforts in East Asia seem partly as a response to regionalism elsewhere.

Trade and investment liberalization under the WTO have been slow and uncertain. The GATT/WTO process became increasingly difficult with the large and diverse membership. It took 8 years to conclude the Uruguay Round negotiations. The Doha Development Agenda was launched in November 2001 but its progress has been facing severe difficulties. FTAs are considered as “WTO plus”, which means they are usually faster than WTO process and broader than WTO coverage. FTAs in East Asia are comprehensive close economic partnership agreements (CEPs), which include the liberalization of trade in goods and services, investment, as well as economic cooperation.

I.2 Rationale for an EAFTA

The East Asia Vision Group (EAVG) in its 2001 Report “*Towards an East Asian community*” recommended: “East Asia moving from a region of nations to a bona fide regional community” and “establishment of the East Asian Free Trade Area (EAFTA) and liberalization of trade well ahead of the APEC Bogor Goal”. The rationale for EAFTA lies firmly in both economic and political interests of all East Asian countries.

Economic theory and modeling results show that a larger FTA can create more benefits than a smaller one. Hence the economic benefits from EAFTA are expected to exceed those from AFTA, any ASEAN+1 FTA, or any other bilateral and sub-regional arrangement. East Asia is currently the world’s most dynamic economic region and could play an important role as a global engine of growth.

EAFTA will enable East Asian countries to meet the challenges of globalization, the emergence of economic blocs in the Americas, Europe and elsewhere.

EAFTA will comprise a wider mix of economies at different levels of development and industrial and technological competence. Complementarities and diversities will provide for efficient regional

production. The removal of various trade and investment impediments will facilitate the full realization of East Asian production networks and the potentials of intra-regional trade as well as make East Asian production more internationally competitive.

The smaller and less developed East Asian countries could become marginalized with the proliferation of sub-regional and bilateral FTAs, as they lack the attraction of a sizeable market and lack negotiating resources. Membership in EAFTA will draw them into the mainstream of trade and investment development and growth in East Asia. This will help to narrow the development gap in East Asia.

East Asia has multi-layered and overlapping FTAs. Market consolidation is necessary to achieve economies of scale and overcome the “spaghetti bowl” effect. The various East Asian FTAs have their own agreed rules of origin, customs procedures, product and technical standards and conformance requirements, timetables for tariff reductions and sensitive and exclusion lists.

This proliferation of rules and timelines is confusing and adds to business information and transaction costs and reduces the scope for economies of scale and attractiveness of the region for foreign direct investment.

The experiences of the EU and ASEAN have shown that closer economic cooperation and integration help reduce political and military conflicts. An EAFTA would increase awareness of a common destiny, institutionalize dialogues and contacts and increase mutual understanding and cooperation. An EAFTA will surely help to create shared benefits and mutual trust, and contribute to the region's peace, stability, prosperity and progress.

While recognizing the shared responsibility for global prosperity and the need for multilateral cooperation, a larger East Asian grouping would increase the East Asian "voice" in international organizations and fora, in equal partnership with the Western Hemisphere and Europe.

II . The Benefits of EAFTA

II.1 Expected Benefits of EAFTA

The members of EAFTA can expect economic benefits from the formation of EAFTA, as the removal of barriers on trade and investment between the members leads to expansion of trade and investment.

The benefits of trade expansion can be categorized into two types, static and dynamic benefits. Static benefits in the form of economic growth and welfare arise from an improvement in resource allocation with the removal of trade distortions. In addition to the static benefits, dynamic benefits can be expected from the EAFTA. Dynamic benefits include mainly scale effect and competition enhancing effect, both of which would increase production and economic welfare of the EAFTA members.

The scale effect may arise from the formation of a larger integrated market as a result of an FTA. Faced with a larger market, firms may be able to exploit the benefits of economies of scale, leading to the reduction in production costs, which in turn would give benefits to consumers. Pro-competition effect may be expected as competition in EAFTA member countries' market is likely to intensify as a result of trade liberalization. Pro-competition effect may give rise to new products and new technology, which in turn would benefit consumers in EAFTA members.

The benefits of EAFTA are significantly larger if it includes not only liberalization in trade in goods and services, but also liberalization in foreign direct investment (FDI), facilitation in trade and FDI, and

economic cooperation. Similar to the beneficial impacts of expanded trade on EAFTA members, FDI expansion contributes to economic growth and welfare of EAFTA members through static and dynamic effects. The impacts of FDI expansion are likely to be larger compared to those of trade expansion. This is because FDI transfers not only financial resources for fixed investment but also technologies and management know-how, which contribute to economic growth. Besides, FDI tends to promote foreign trade, which in turn contributes to economic growth and welfare.

Economic cooperation under the EAFTA contributes to economic growth of developing countries, since it contributes to the development of various types of capacities necessary for the promotion of economic development. Among the capacities, the most important for economic development is human resources. Human resource development program in EAFTA would certainly contribute to the development and efficient use of human resources. In addition, institution building such as establishing reliable and transparent legal system, and infrastructure building such as construction of communication and transportation systems, which can be included in EAFTA program, would certainly contribute to economic growth of the developing members.

II.2 Simulation Results

To examine the possible impacts of EAFTA, we adopt a computable general equilibrium (CGE) model, which mimics the actual economic activities by explicitly incorporating market mechanism². The EAFTA in our simulation includes the elimination of all tariff and non-tariff barriers on trade in goods between the member countries while it maintains the same tariff and non-tariff barriers on trade with non-members. In addition to the liberalization of trade barriers, the EAFTA here includes trade facilitation program for the member countries. Trade facilitation program, which takes various forms such as the simplification of customs procedures and harmonization of technical standards, reduces the impediments to trade.

The results of our simulation analysis show that East Asian countries will benefit from EAFTA, as they can expect an increase in both production (GDP) and economic welfare (i.e. consumers' satisfaction). EAFTA would increase overall GDP of East Asian countries by 1.2 percent and

² Among several CGE models, we adopt the GTAP model with the most up-to-date GTAP version 6 database for the year 2001. The GTAP version 6 database has 87 countries/regions and 57 sectors. In our analysis, 87 countries/regions are aggregated into 15 countries/regions, and 57 sectors are aggregated into 15 sectors. Our analysis focuses on the following 9 countries out of 15 countries/regions as potential EAFTA members: China, Japan, Korea, and 6 ASEAN members (Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam). Brunei, Cambodia, Laos and Myanmar are not included in the analysis because of the lack of necessary data for the analysis.

economic welfare by 104.6 billion US dollars.³ The impacts on GDP growth will be greater for the ASEAN countries when compared to the three Northeast Asian countries (China, Japan and Korea). Specifically, EAFTA will result in 3.6 percent increase of ASEAN's combined overall GDP, while the corresponding value for the three countries is at 0.9 percent.

The impacts of EAFTA on its member countries largely depend on the initial level of import barriers and the importance of foreign trade in their economic activities (trade/GDP ratios). We generally find the following relationship among the EAFTA countries: the higher the level of import barriers, and/or the larger the trade/GDP ratios, the greater the gains from EAFTA.

At individual member level, wide variations can be expected (See the results in the table). It should be emphasized that all of them gain in terms of GDP as well as economic welfare.⁴

³ Our simulation results are likely to underestimate the impacts of EAFTA because of the limitations of the model. One serious limitation of the model is the exclusion of international movement of factors of production including capital and labor. One of the most striking developments in international economic activities in recent years is globalization of economic activities, which has been propelled by active international movement of capital and, to lesser extent, labor. Despite the increasing importance of international capital and labor movement, such developments have not been successfully incorporated in the GTAP model. Another limitation of the GTAP model is its inability in incorporating the "dynamic" impacts of EAFTA, although FTA is expected to generate dynamic effects in the forms of improving efficiency, or productivity of the firms and industries and other positive effects. These mechanisms are not incorporated in the model.

⁴ Within a country, there would be a variation in impacts across sectors, which require the proper

Effects of EAFTA on East Asian Countries

Country	Increase in GDP (%)	Increase in welfare (\$million)
China	1.66	18,230
Japan	0.44	29,844
Korea	3.54	18,845
Indonesia	1.74	4,498
Malaysia	5.83	10,420
Philippines	4.02	3,410
Singapore	4.21	7,509
Thailand	4.50	8,798
Vietnam	2.83	3,029
ASEAN	3.64	37,663
CJK	0.92	66,919
ASEAN+3	1.18	104,582

Source: Simulation results.

III. Modality for an EAFTA

adjustment measures by respective governments to mitigate negative impacts.

The initial conditions in East Asia form an important foundation for an EAFTA. As East Asian countries have been undergoing continuous trade and investment liberalization, an EAFTA with trade and investment as its core is highly desirable. MFN tariff rates in the region have already been brought down substantially, and the strong trade-FDI nexus has led to the emergence of internationally competitive production networks involving East Asian economies. It is thus in the interests of East Asian countries to strengthen market-driven integration in the region by institutionalizing it.

East Asia should strive for a high quality FTA by being comprehensive in scope, removing trade and investment barriers, strengthening capacity and fostering open regionalism. It will lead to further deepening of economic integration, enhance the competitiveness of production networks, and progressively reduce gaps among East Asian countries. A number of bilateral and sub-regional agreements concluded in East Asia are aimed at comprehensive agreements. These initiatives have been dubbed as “FTA-plus” and “WTO-plus”, and their scope extend beyond the traditional FTA and beyond what is covered in the WTO.

III.1 Principles

An EAFTA must be beneficial to all its members. Maximum economic

benefits can be gained by being comprehensive in scope and providing for substantial liberalization in all sectors. Comprehensiveness also implies that liberalization measures are complemented by facilitation and development cooperation efforts. The following principles should guide the design, negotiation, and formation of this region-wide agreement.

First, in supporting sustained national economic reform, the agreement must be “liberalizing”. The agreement must lead to a substantial liberalization of trade in goods and services, including the sensitive sectors. This means that sensitive sectors must not be excluded from the agreement. They can be placed in a sensitive list under the discipline of the agreement, and over time the list of sensitive items will be progressively reduced and ultimately eliminated, in conjunction with the requisite adjustment policies. The phasing-out periods should be kept to a minimum. An EAFTA must lead to liberalization more quickly than it would be through multilateral negotiations.

Second, in view of the economic diversity of countries in East Asia, the agreement must take into account the need for capacity building among its members. The agreement must contain elements that help reduce development gaps in the region. Various facilitation and economic cooperation efforts involving all members can help build capacity. In

addition, there will be need to provide for meaningful special and differential (S&D) treatment as well as specific mechanisms for assisting countries that are still behind in their economic development. Such treatment and assistance must also come under the discipline of the agreement. As the EAFTA is a means to achieving an East Asian community, the principle of “strengthening capacity” is an essential element of the agreement.

Third, in strengthening market-driven integration, East Asia must foster “open regionalism”, and EAFTA should minimize the discriminatory effects. The main purpose of EAFTA is to remove trade and investment barriers in the region so as to increase efficiency of economic transactions in the region as well as with the world at large.

A high quality EAFTA must incorporate all the above principles. It is important that EAFTA should be negotiated and implemented as a single package. Strong political will and spirit will be highly needed for the successful negotiation and implementation of the agreement.

III.2 Elements of a Comprehensive Agreement

A comprehensive free-trade agreement is understood to contain (but not

limited to) the following elements:

Trade in goods

Customs procedures

Technical barriers to trade

Rules of origin

Trade in services

Labor mobility

Investment

Competition policy

Intellectual property

Government procurement

Facilitation schemes

Consultations and dispute settlement

Economic cooperation

Institutional framework for policy dialogues

EAFTA should be WTO-plus in the areas of trade in goods and trade in services. It should also introduce investment provisions covering both liberalization and protection aspects, and it should adopt rules of origin that are simple and efficient. S&D treatment should be introduced as part of a coherent package of assistance to those that are still behind in their development.

As for trade in goods, the coverage of the agreement should be as comprehensive as possible, to cover “substantially all the trade” as required under GATT Article XXIV. EAFTA should adopt the most liberalizing interpretation of this Article.

Another important area that needs to be addressed pertains to rules of origin, which could be subject to abuse. These could have adverse effects on trade and investment. In East Asia, this will be most counterproductive to the smooth operation of the extensive production networks and supply chains. Rules of origin should be trade facilitating, simple and easily enforceable.

The services element in the agreement poses some special and important challenges. The essence of free trade agreements in services under the GATS Article V is the elimination of substantially all restrictions and discriminations. Beyond this, members of EAFTA should engage in policy consultations with the aim of rationalizing domestic regulations governing the services sectors covered.

The agreement on investment covers the liberalization of investment regimes and the promotion as well as protection of investment. National

treatment (at the pre-establishment and post-establishment phases) and protection of investment are key features of the agreement. As many East Asian countries have already included national treatment in their investment laws, the agreement on investment should not pose great difficulties. National investment laws usually also have non-discrimination provisions. This suggests that the investment element of the EAFTA should also have a non-discrimination provision.

The EAFTA should also address the issue of intellectual property rights (IPR). Building upon the achievements of the TRIPS Agreement and the harmonization initiatives under the auspices of the World Intellectual Property Organization, the East Asian countries, through the EAFTA, should aim at enhancing the overall level of IPR protection. The EAFTA should aim at establishment of more transparent and streamlined national procedures for IPR protection and adequate and effective IPR enforcement mechanisms, coupled with initiatives towards enhancing capacities for IPR protection in the region.

IV. Road Map to an EAFTA

An EAFTA roadmap would naturally be related to the objective and contents of the EAFTA. In fact, the choice of road map will correlate to

the type of EAFTA, and the latter will depend on the reasons behind why each of the East Asian countries is seeking to form an EAFTA.

IV.1 Paths towards an EAFTA

An EAFTA may be reached through different paths. Among them, the following scenarios deserve special attention.

First, considering recent developments in bilateral FTAs in East Asia, one probable scenario for an EAFTA seems to be through a series of ASEAN+1 FTAs. Since China, Japan, and Korea are each pursuing an FTA with ASEAN, these ASEAN+1 FTAs, when realized, could serve as the basic framework for an EAFTA. In 2004, China and ASEAN signed the Agreements for Trade in Goods and Dispute Settlement Mechanisms and the implementation took place on July 1, 2005, while the negotiations for service and investment agreements are under way and expected to be completed in 2006. Korea and ASEAN (except Thailand) signed the agreement for trade in goods in April 2006. Japan-ASEAN FTA is still under negotiation and is expected to finish by 2007. The main advantage of this path is that EAFTA can begin from the existing ASEAN+1 FTAs. On the other hand, based on the experiences of ongoing ASEAN+1 FTAs, it will be difficult to converge the three ASEAN+1 FTAs into an EAFTA.

Secondly, an EAFTA can be formed between ASEAN (AFTA) and CJKFTA (China, Japan and Korea). An EAFTA cannot be formed unless there is a de facto CJKFTA. However, given the current situation of their FTA strategies and the political relations between the three countries in particular, a CJKFTA is not likely to be pursued by the governments of the three countries in the near future. Since 2003, only a trilateral joint research project has been conducted on a possible CJKFTA by the institutes from each of the three countries. Bilateral FTAs between three Northeast Asian countries have made slow progress. Korea-Japan FTA negotiations, which started in December 2003, are showing slow progress. A joint study on a China-Korea FTA is under way between institutes from the two countries.

Thirdly, an EAFTA could be achieved using the existing ASEAN+3 framework. Following the first ASEAN+3 Summit Meeting in December 1997, the ASEAN+3 framework was consolidated as a forum and a main vehicle for regional economic cooperation in East Asia. It was within the ASEAN+3 framework that EAVG recommended the formation of an EAFTA, and in November 2002, the East Asia Study Group (EASG) proposed the formation of an EAFTA as one of the nine mid-term and long-term measures. The Joint Expert Group for Feasibility Study on

EAFTA (JEG), which was created following the decision of ASEAN+3 Economic Ministers' Meeting in 2004, can also be regarded as the first concrete step in this direction. Should there be political determination of the leaders, an independent process to form an EAFTA could be launched. In this independent process, an EAFTA could be devised, taking into account all existing and ongoing East Asian FTAs, while not necessarily being restricted by them.

IV. 2 Timing of an EAFTA

All of the above scenarios are likely to produce concurrent synergy effects for East Asian economic integration. However, the timing of an EAFTA will vary, depending on the progress of ongoing FTA negotiations, the type of EAFTA envisioned, and especially the political will of East Asian leaders.

The following factors should be considered when designing an EAFTA schedule:

--The EAVG recommended the formation of an EAFTA well ahead of the Bogor Goal set by APEC. According to the Bogor Declaration, APEC's developed economies should achieve the goal of a free trade and investment area no later than 2010, and developing economies, no later

than 2020.

--According to ASEAN documents, the ASEAN Economic Community (AEC) will be a “single market and production base by 2015.” The AEC is likely to be an FTA-plus with elements of a common market.

--The target years for an ASEAN-Korea FTA, an ASEAN-China FTA, and an ASEAN-Japan FTA were set at 2009, 2010 and 2012, respectively.

--The negotiations of ASEAN+1 FTAs are likely to be concluded by 2007 or 2008.

Thus, the possible schedule of an EAFTA, assuming the creation of an independent process for the formation of an EAFTA, may be designed as follows:

--Declaration of the launch of the independent process for EAFTA during the 10th ASEAN + 3 Summit

--Creation of working groups for EAFTA negotiations in 2007

--Begin EAFTA negotiations in 2009

--Conclude EAFTA negotiations by 2011

--Complete EAFTA by 2016 (CLMV not later than 2020)

IV. 3 EAFTA Membership

Given the outward orientation of the East Asian economies, EAFTA

membership should not be exclusive. However, as for the original membership, it would be more realistic for the EAFTA to be firstly negotiated among the ASEAN+3 countries because of the existing ASEAN+3 framework. In view of the recent expansion of FTA initiatives, membership will be open to other East Asian economies, as well as other members of East Asia Summit.

IV. 4 Relations with Other FTAs

In the process of forming an EAFTA, all FTAs involving East Asian countries, existing or under negotiation, can serve as the references. Among them, ASEAN+1 FTAs will be of particular importance, because not only are these agreements between ASEAN, a key binding element for an EAFTA, and China, Japan and Korea, but they are also expected to be completed in the near future. However, it is also evident that an EAFTA cannot be constructed using only those elements that exist in other East Asian FTAs. If an EAFTA is formed on the basis of the least common denominators of the existing FTAs, it is likely to be a low quality FTA. Therefore, an EAFTA should go beyond existing East Asian FTAs.

Another key issue is related to the relations between an EAFTA and other

East Asian FTAs when it is realized. If East Asian countries choose to form an EAFTA that would co-exist with many other East Asian FTAs, this would create multi-layered complex FTA webs in East Asia and the “spaghetti bowl” effect would worsen. Therefore, it is necessary to pursue a high quality EAFTA that would go beyond the other FTAs among East Asian countries.

IV. 5 Approach and Related Issues

Diversity is a fundamental feature of the East Asian region. An EAFTA should be designed so that all parties would benefit from it. In particular, it must be helpful in reducing the development gaps in East Asia.

Within the framework of a single package, a gradual and progressive approach should be adopted. The following issues must be addressed:

--One may start with implementation of the commitments in trade in goods and services, and then investment.

--One should give the less developed economies more time for implementation and adjustment.

--Given the diverse nature of the economies and social conditions, certain flexibility could be accorded to the implementation schedule, but a clearly defined timetable for liberalization needs to be provided.

With a view to helping the less developed countries, economic development cooperation initiatives with specific action plans must be adopted along with the EAFTA.

V. Major Recommendations

1. We recommend that East Asian leaders put EAFTA on the economic cooperation agenda in 2006 during the 10th ASEAN+3 Summit and an independent process to form an EAFTA could be launched in 2007 as one of the major initiatives in the Second Joint Statement on East Asian cooperation. The foundation of EAFTA has been gradually built up through the developments of economic integration and cooperation, as well as FTA efforts. Increasing economic integration of the economies of East Asian region encourages all members of the region to approach EAFTA. The results of our simulation analysis show that East Asian countries will benefit from EAFTA, as they can expect an increase in both GDP and economic welfare.

2. We recommend that EAFTA process will firstly start within the ASEAN+3 framework, because it has already established a solid foundation. An EAFTA could be devised, taking into account all existing

and ongoing East Asian FTAs, while not necessarily being restricted by them. While supporting ASEAN's leading role in this process, it is important to encourage the three Northeast Asian countries, i.e. China, Japan and Korea to play an active role. The EAFTA is not exclusive, and in view of the recent expansion of FTA initiatives, membership will be open to other East Asian economies, as well as other members of East Asia Summit.

3. We recommend that EAFTA must be of high quality that will lead to further deepening of economic integration, enhancing the competitiveness of production networks, and progressively reducing the development gaps among East Asian countries. Maximum economic benefits can be gained by being comprehensive in scope with substantial liberalization in all sectors. Comprehensiveness also implies that liberalization measures are complemented by facilitation and development cooperation efforts, accompanied by an institutional framework for broad-based policy dialogues among members.

4. We recommend that economic development cooperation initiatives with specific action plans must be adopted along with the EAFTA with a view to helping the less developed countries. EAFTA is a means to achieving an East Asian community. In view of the economic diversity

of countries in East Asia, it should take into account the need for capacity building among its members.