

# Realizing the East Asia Vision

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## **ABSTRACT**

This paper examines the developments of three separate FTAs between ASEAN and the +3 countries. It is still unclear how these separate FTAs will be amalgamated into an EAFTA, and whether that can happen before 2020. This paper argues that much will depend on the pace of ASEAN's own economic integration. The likely alternative is that China will become the main driver of the process.

Keywords: East Asia, ASEAN, ASEAN+3, free trade agreement

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# Realizing the East Asia Vision

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## Introduction

The East Asia Vision is that of creating a regional community (small c). As described by the East Asian Vision Group (EAVG), it is *an East Asian community of peace, prosperity and progress*. This vision has been adopted by the ASEAN+3 governments. The ASEAN+3 process is still rather loose, and is seen as being ASEAN driven. However, the +3 countries (China, Japan and South Korea) have significantly influenced its agenda.

Cooperation in the economic field is seen as the catalyst in the comprehensive community-building process. The EAVG recommended the formation of an East Asia Free Trade Area (EAFTA), the establishment of an East Asia Investment Area (EAIA), and greater financial integration.

Cooperation in finance began with the Chiang May Initiative of bilateral swap arrangements between a number of ASEAN countries and the +3 countries. Cooperation in finance was expected to be the main driver towards East Asia economic integration. This swap arrangement has yet to be multilateralized and its amount is far from sufficient. The group also needs to produce a credible surveillance process before the arrangement can be strengthened. The progress has not been as rapid as initially expected.

ASEAN+3 Economic Ministers have recently agreed to study the impact of an EAFTA. In academic and other non-government circles different approaches to forming EAFTA have been considered. One approach is through {3 x (ASEAN+1)}. The second is to first develop an arrangement in Northeast Asia (China, Japan, Korea), and subsequently link it to ASEAN. The third is an ASEAN+3 process. Although no efforts have been made to

forge an agreement amongst East Asian governments on which approach to take, it appears that the {3 x (ASEAN+1)} is the route taken now that ASEAN and Korea have also agreed on forming a FTA. This suggests that ASEAN must act as a hub, which in turn means that ASEAN must strengthen and accelerate its efforts to realizing the ASEAN Economic Community and must develop a common framework in its external economic relations as discussed above. This is in line with ASEAN's position as the driver in the ASEAN+3 process. However, the ASEAN+3 process is in danger of being weakened by recent attempts to develop a parallel East Asian Summit process.

This short paper examines the developments of three separate FTAs between ASEAN and the +3 countries. It is still unclear how these separate FTAs will be amalgamated into an EAFTA, and whether that can happen before 2020. This paper argues that much will depend on the pace of ASEAN's own economic integration. The likely alternative is that China will become the main driver of the process.

### **A Review of ASEAN+1 Initiatives**

It all began with the approaches by China. ASEAN on its part did not regard free trade areas (FTAs) as a major element in its international economic diplomacy. ASEAN's own economic integration has been the priority since the decision in 1992 to form an ASEAN Free Trade Area (AFTA), which was followed by initiatives in the fields of investment (AIA) and services (AFAS), and a few other measures. Beyond ASEAN, its trade liberalization efforts are directed at the multilateral level, the WTO's Doha Development Agenda. At the regional level, ASEAN members of APEC attempt to continuously improve their Individual Actions Plans (IAPs) under the region's modality of concerted unilateral liberalization towards free and open trade and investment in the region in 2010/2020. APEC, as distinct from WTO, is a voluntary and non-binding process. The proposal for an East Asia Free Trade Agreement (EAFTA) was presented by an East Asian Vision Group to the ASEAN+3 leaders as a means to realize an East Asian community, but EAFTA is seen as a long-term effort.

In 2001, at the ASEAN-China Summit in Bandar Seri Begawan, China came up with a proposal to establish an ASEAN-China Free Trade Area within ten years. It was understood in many quarters in ASEAN that the agreement reached at that Summit was only to study the proposal. In the course of the development, however, both sides were engaged in a negotiation. Within one year, at the Summit meeting in Phnom Penh in November 2002, the Heads of State of ASEAN and China were ready to sign a Framework Agreement on Comprehensive Economic Cooperation (CEC), which included a FTA.

There is no doubt that China's proposal essentially was politically motivated (Sheng, 2002; Soesastro, 2003), but China and ASEAN both saw the economic significance of the initiative. However, the process appeared to have been driven largely by China. Having participated in a lengthy and difficult process of WTO accession, China has acquired sufficient expertise to negotiate a trade deal. The deal was made attractive for ASEAN with the introduction of an Early Harvest program. In a way, it can be said that ASEAN, at least initially, was dragged along by China. China's initiative was immediately followed by a proposal from Japan. This was to be expected as Japan naturally did not want to be left out. Since then ASEAN has been courted by other countries and have entered into an agreement with a few other countries. However, to date there is as yet no ASEAN document that clearly spells out ASEAN's strategy of engagement in FTAs with its trading partners.

#### *ASEAN-China*

The Framework Agreement on CEC contains three elements: liberalization, facilitation, and economic cooperation. In addition it has a provision on the mechanism to implement the Agreement, including a dispute settlement mechanism. The liberalization element covers trade in goods, trade in services, and investment. In the context of liberalization, the Agreement provides for special and differential (S&D) treatment and flexibility to the newer ASEAN members as well as flexibility to address sensitive areas.

The Framework Agreement contains an Early Harvest program that covers all products in chapters 01 to 08 at the 8/9 digit level (HS Code): live animals; meat; fish; dairy produce; other animals products; live trees; edible vegetables; and edible fruits and nuts. Products under this program are divided into three categories for tariff reduction and elimination, but tariffs will have to be brought to zero for all three categories within three years. However, the program allows for an Exclusion List and different timeframes between the ASEAN-6 (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) and the CLMV (new members – Cambodia, Laos, Myanmar and Vietnam), for whom zero tariffs will be reached in 2010. Initially it was thought that China would offer the Early Harvest program on a non-reciprocal basis, but this turned out not to be the case. Moreover, some agricultural commodities of great interest to ASEAN, such as rice and palm oil, were excluded from the program. Some ASEAN countries (e.g. the Philippines) did not immediately join the program.

Beyond the Early Harvest, tariff reduction and elimination will be pursued along two tracks, the normal track and the sensitive track. Applied MFN tariffs of products listed in the normal track should be gradually reduced or eliminated in accordance with specified schedules and rates over a period from 1 January 2005 to 2010 for ASEAN-6 and China, and over a period from 1 January 2005 to 2015 for CLMV. Reduction of tariffs of products in the Sensitive List will be in accordance with mutually agreed end rates and end dates. The number of products in the Sensitive List is subject to a maximum ceiling, also to be mutually agreed upon.

The Framework Agreement was amended on 6 October 2003. The Protocol of amendment incorporated the Rules of Origin (ROO) applicable to the products covered under the Early Harvest program. It also included subsequent Early Harvest agreements between some ASEAN members and China, and it clarified the implementation of the provision of the program as well as the terms and conditions for the acceleration of the tariff reduction and elimination through bilateral or plurilateral agreements.

The negotiation on the FTA for goods (beyond the Early Harvest) was to be concluded by 30 June 2004. This was a rather ambitious timeframe, and indeed, the deadline was missed. The parties could not agree on the maximum number of tariff lines in the sensitive list. However, as political leaders were determined to begin the process of tariff reduction and elimination on 1 January 2005, a compromise was struck, and Ministers were able to sign an agreement at the ASEAN Summit in Vientiane in November 2004. This does suggest the importance of setting target dates.

The Agreement on Trade in Goods of the Framework Agreement on CEC, or for short, the ASEAN-China FTA (ACFTA), is only the first portion of a series of agreements to implement the Framework Agreement. At the Vientiane Summit, Ministers also signed an Agreement on Dispute Settlement Mechanism of the Framework Agreement on CEC. They will be followed by an agreement on services, an agreement of investment, and other agreements. It is indeed rather surprising that ASEAN and China were able to produce those two agreements within a short time.

The ACFTA contained the modality for tariff reduction and elimination for tariff lines both in the normal track and the sensitive track. In the normal track there are three sets of schedules. The first applies to ASEAN-6 and China. The implementation will begin on 1 July 2005, when applied MFN tariff rates will be brought down to 20%, 15%, 10% and 5% for tariffs still above 5%. By 2007 they will be reduced to 12%, 8% and 5%, and by 2009 to 5% and 0%, and finally by 2010 all rates will become zero. The second schedule applies only to Vietnam, where all tariffs will be brought down to 0% in 2015. The third schedule applies to Cambodia, Laos and Myanmar, where some tariffs will still be higher than in Vietnam's schedule, but from 2011 onwards they will be the same.

In addition, agreement was also reached to bring as many tariff lines to the 0-5% range. For instance, for ASEAN-6 and China, by 1 January 2007 at least 60% of tariff lines placed in the normal track must be reduced to 0-5%. However, some "flexibility" is allowed in 2010, whereby up to 150 tariff lines could still have tariffs but should be

eliminated not later than 1 January 2012. For the CLMV countries, this flexibility allows for having tariffs on up to 250 tariff lines to be eliminated not later than 1 January 2018.

In terms of tariff lines in the sensitive track, the Agreement subjects the number of tariff lines to a maximum ceiling. Tariff lines in the sensitive track are further classified into Sensitive List and Highly Sensitive List. For ASEAN-6 and China, the maximum ceiling is 400 tariff lines at the HS 6-digit level and 10% of total import value, based on 2001 statistics. The Highly Sensitive List should have not more than 40% of the total number of tariff lines in the sensitive track or 100 tariff lines at the HS 6-digit level, whichever is lower. For CLMV, the maximum ceiling is 500 tariff lines. To note, tariff lines at the HS 6-digit level for the ASEAN-6 countries varies between 5,600 (Philippines) and 10,400 (Malaysia). The number of tariff lines in the Sensitive and Highly Sensitive Lists is shown in Table 1. Applied MFN tariff rates in the Sensitive List must be reduced to 20% not later than 1 January 2012 and to 0-5% not later than 1 January 2018. For CLMV countries, the target dates are 1 January 2015 and 1 January 2020, respectively. In any case, the sensitive track will be reviewed in 2008.

Table 1 ASEAN-China FTA: Tariff Lines in Sensitive and Highly Sensitive Lists (HS 6-digit)

Country	Sensitive	Highly Sensitive
Brunei	66	34
Cambodia	350	150
Indonesia	349	50
Lao PR	88	30
Malaysia	272	96
Myanmar	271	0
Philippines	267	77
Singapore	1	1
Thailand	242	100

Vietnam	..	..
China	161	100

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The modality for tariff reduction and elimination in this Agreement resembles AFTA’s CEPT (Common Effective Preferential Tariff) reduction scheme. Experience in AFTA suggests that this modality does result in reductions in accordance with the schedule and in fact also brings about acceleration in the reduction and the progressive transfer of tariff lines from the sensitive track to the normal track.

The Rules of Origin (ROO) for the ACFTA as stipulated in the Agreement (Annex 3) are as follows: “a product shall be deemed to be originating if: (i) Not less than 40% of its content originates from any Party; or (ii) If the total value of the materials, parts or produce originating from outside of the territory of a Party (i.e. non-ACFTA) does not exceed 60% of the FOB value of the product so produced or obtained provided that the final process of the manufacture is performed within the territory of the Party.” In addition the Cumulative Rule of Origin applies provided that the aggregate ACFTA content, i.e. full cumulation, applicable among all Parties, on the final product is not less than 40%. Also, products that satisfy the Product Specific Rules, i.e. products that have undergone sufficient transformation in a Party, will be treated as originating goods of that Party. The ROO in the ACFTA is also similar to that in AFTA. It is relatively simple and quite liberal. In fact, ACFTA should be commended for this, and perhaps is an example of “best practice” in this regard.

It is also to be noted that the ACFTA explicitly adopts GATT 1994 provisions on national treatment on internal taxation and regulation, transparency, BOP safeguard measures. It also abides to the provisions of the WTO disciplines on, among other things, non-tariff measures, technical barriers to trade, sanitary and phyto-sanitary measures,

subsidies and countervailing measures, anti-dumping measures and intellectual property rights.

The Agreement on Dispute Settlement centers on arbitral proceedings in case consultations fail to settle a dispute. The Agreement stipulates the appointment, composition, functions and proceedings of Arbitral Tribunals. It enters into force on 1 January 2005. How well this mechanism will function will be known only when it is being used. This mechanism is perhaps more straightforward than the one recently adopted by ASEAN as part of its efforts to realize the ASEAN Economic Community. The ASEAN mechanism is yet to be tested as well.

The ACFTA might become a model for other ASEAN FTAs, particularly if the partner country is a developing country. It should be noted that while tariff reduction and elimination are scheduled to be completed in 2010 for the ASEAN-6 and China, and 2015 for the CLMV countries for the normal track, reduction of tariff lines in the sensitive list (to 0-5%) could be extended to 2018 and 2020, respectively. It should be in interest of ASEAN and China to try to accelerate this process. The modality adopted in the Agreement can accommodate this. However, political will has to be there for this to happen. It also should be noted that the ACFTA is only the first step in the implementation of the Framework Agreement. Negotiating an agreement in services and investment may prove to be more difficult.

To conclude on a more optimistic note, it may well be that ASEAN's engagement in FTAs with other trading partners could create a kind of competition amongst the various FTAs that might lead to acceleration of their completion.

#### *ASEAN – Japan*

In January 2002, during his visit to Singapore, Prime Minister Koizumi of Japan announced Japan's interest to form an Economic Partnership agreement with ASEAN, which might have a FTA component. Japan has completed a bilateral FTA with

Singapore, the Japan Singapore Economic Partnership Agreement (JSEPA), which is the first FTA for Japan. Japan also wants to develop FTAs with individual ASEAN countries on a bilateral basis. It was immediately obvious that Japan was reacting to the earlier move by China towards ASEAN that led to the decision in November 2001 to develop an ASEAN-China Comprehensive Economic Cooperation Agreement.

At the ASEAN-Japan Summit in November 2002, in their Joint Declaration the Heads of State/Governments agreed to implement measures for the realization of a Comprehensive Economic Partnership (CEP), including elements of a possible FTA, which should be completed as soon as possible within 10 years. A Committee was established to draft a framework for the realization of an ASEAN-Japan CEP.

In October 2003 in Bali ASEAN and Japan signed a Framework for Comprehensive Economic Partnership (CEP). Both sides agreed to adhere to the following principles:

- (a) The ASEAN-Japan CEP should involve all ASEAN members and include a broad range of sectors focusing on liberalization, facilitation and cooperation activities;
- (b) The integrity, solidarity and integration of ASEAN will be given consideration in the realization of the ASEAN-Japan CEP;
- (c) The Agreement should be consistent with the rules and disciplines of the WTO Agreement;
- (d) Special and differential treatment should be provided to ASEAN members in recognition of their different levels of economic development, and additional flexibility should be accorded to the newer ASEAN members;
- (e) Flexibility should be given to address the sensitive sectors in each ASEAN member and Japan; and
- (f) Technical cooperation and capacity building programs should also be considered.

The above suggests that an ASEAN-Japan CEP will not be too different from ACFTA, except that there will be no Early Harvest program. The Japanese side has insisted that the Agreement should be a “single undertaking”. The negotiations were scheduled to

begin in 2005. It remains to be seen whether such a single undertaking could be negotiated within a reasonable time frame. Both sides want to realize the Agreement by 2012.

An Agreement with Japan, being a developed economy, must strictly adhere to Article XXIV of the WTO to cover substantially all trade. There cannot be a long Exclusion List of sensitive items. The ACFTA could avail itself of the WTO enabling clause. Nonetheless ASEAN and China agreed to limit the so-called sensitive track to 10% of total import value. The Japanese side has made it known that in their understanding “substantially all trade” could mean at least 90% of the value of trade. This still has to be negotiated with ASEAN. It should also be closely observed whether the ASEAN-Japan CEP will adopt an equally simple and liberal Rules of Origin (ROO) as in AFTA and ACFTA.

The problem is that Japan already has a bilateral agreement with an ASEAN country, Singapore, which has adopted a ROO that is less liberal than AFTA and ACFTA, and Japan is now negotiating similar agreements with Thailand, the Philippines and Malaysia. It is not immediately clear whether the ASEAN countries will insist on the adoption of AFTA’s ROO in their bilateral FTAs with Japan. The CEP between ASEAN and Japan signed in Bali stipulated that schedules of liberalization concessions between Japan and individual ASEAN countries that have concluded a bilateral FTA or EPA (Economic Partnership Agreement) will not be renegotiated and will be annexed to the ASEAN-Japan CEP Agreement. Nothing is said about the ROO.

Japan has adopted a dual strategy in regard to negotiating free trade agreements with ASEAN, namely with ASEAN as a group and selectively with certain ASEAN countries. The strategy is to move faster on the latter. It has been said that the origin of this dual strategy was bureaucratic in that METI was championing for an agreement with ASEAN while Gaimusho (MOFA) preferred bilateral agreements. MOFA thought that it would be very difficult for Japan to have FTAs with the CLMV countries.

How Japan will handle this problem in the ASEAN-Japan CEP is unclear. It can make use of the S&D principle to provide a longer time frame for the CLMV countries as in the case of ACFTA. However, since Japan is negotiating bilateral FTAs with most of ASEAN-6, it could well be that the liberalization schedules will be different even amongst ASEAN-6, and that similar agreements with CLMV will be postponed to a later date. The focus of the agreement with CLMV will be initially on facilitation and cooperation. This could suggest that the ASEAN-Japan CEP will essentially be an umbrella agreement for separate FTAs. It is unclear whether this is consistent with the principle of a single undertaking.

In this sense, the agreement with Japan could be different from the agreement with China. In the ACFTA, ASEAN can act as a “hub”, but in relation to Japan, ASEAN countries could become “spokes”.

#### *ASEAN – Republic of Korea (ROK)*

Until recently, Korea resisted to take part in the bilateral FTA game with ASEAN. Then President Kim Dae-jung was more interested in promoting the East Asia Community idea. His successor, President Roh, also focuses his attention to initiatives in Northeast Asia, where Korea is to be developed as a business hub. In the end, however, Korea felt that it cannot afford to be left behind by the other Northeast Asian (+3) countries.

A Joint Declaration on Comprehensive Cooperation Partnership (CCP) was signed at the Summit in Vientiane in November 2004. The establishment of an ASEAN Korea FTA (AKFTA) is seen as “a natural extension of the existing relations as well as a stepping stone to elevate the ASEAN-ROK relationship to a higher and more comprehensive level.”

AKFTA will be similar to other ASEAN FTAs in terms of its comprehensive scope and provision for flexibility to deal with the CLMV countries. The possibility of achieving Early Results will be considered in developing a Framework Agreement. However, the kind of Early Harvest program to be included will not be confined to agricultural

products as in the case of the ASEAN-China CEC, but will include manufactured products that are not sensitive to either side. In fact, it might exclude many agricultural products.

The negotiations on AKFTA will commence in early 2005 and completed within two years. While AKFTA was conceived at a much later date than the other FTAs, the intention is to realize it at an earlier date, with a goal of achieving as high a level of liberalization as possible, whereby at least 80% of products will have zero tariffs in 2009, and with consideration for S&D treatment and additional flexibility for the CLMV countries.

AKFTA may well be the Agreement that will drive other FTAs to accelerate their implementation. This could substantiate the point that was made earlier.

### **ASEAN's Critical Role**

It is widely recognized that a stronger and more consolidated ASEAN is critical to the ASEAN+3 process. ASEAN's priority is to deepen economic integration amongst its 10 members. This is a major undertaking in view of the big differences in levels of economic development and economic openness. When AFTA was decided in 1992, ASEAN only had the six members. When joining ASEAN the new members had to accede to the AFTA agreement. They were each given longer time frame. A two-tier ASEAN was created.

In 1997, ASEAN-6 and the new members, charted a new direction, the ASEAN Vision 2020, with the aim to forge closer economic integration and narrowing the gap in the level of development amongst its members. The vision is to “create a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities.”

In 2003, at the Summit in Bali, ASEAN leaders agreed to establish an ASEAN Economic Community (AEC) by 2020. The AEC is one of three pillars (the other two being the ASEAN Security Community and the ASEAN Socio-cultural Community) that make up the ASEAN Community. In line with the ASEAN Vision 2020, it is envisaged that the AEC will be a single market and production base with free flow of goods, services, investments, capital, and skilled labor. The AEC remains vaguely defined. The AEC has been conceptualized as a “FTA-Plus” arrangement that covers a zero-tariff ASEAN free trade area and some elements of a common market. The alternative is “Common Market Minus”, meaning that by 2020 the AEC would be declared a Common Market but it would take into account areas where members countries could reserve deeper integration for a later stage. On this discussion see Hew and Soesastro (2003). ASEAN officials opted for a pragmatic approach, essentially moving on a sectoral basis. Eleven priority sectors have been selected for fast-track integration. The eleven sectors are: wood-based products, automotives, rubber-based products, textiles and apparels, agro-based products, fisheries, electronics, e-ASEAN, healthcare, air travel, and tourism. A roadmap is being drawn for each sector. What remains missing is the overall roadmap towards achieving AEC, although ASEAN has produced an internal document, Roadmap for ASEAN Integration, prior to the decision to move towards an AEC.

At the same time that ASEAN undertakes its AEC project, it has been dragged into FTAs with a number of trading partners. Two immediate issues confront ASEAN. First, can these FTAs be completed before ASEAN realizes the AEC? In terms of the plan (intention), ASEAN-Korea FTA will be completed in 2009, ASEAN-China in 2010, ASEAN-India in 2011, and ASEAN-Japan in 2012, all with some built-in “flexibility”, allowing for some countries or some sectors to be realized later. However, the AEC is scheduled for completion by 2020. This means that ASEAN members must try to accelerate the implementation of their AEC initiatives. At least the fast-track sectors should be fully liberalized by 2010. ASEAN could also adopt an approach which clearly defines the minimum measures to be taken for the region to become a single market and production base, namely so-called “core” elements of the AEC, and all members should agree to implement them by 2010. It is proposed that the following five elements

constitute core elements of AEC: full liberalization of goods trade, free and open investment, selective services liberalization, infrastructure development (especially linking CLMV to the rest of ASEAN), and institutional mechanisms (in particular a dispute settlement mechanism). All other key elements will be called “defining” elements, and should be implemented between 2010 and 2020 (Soesastro, forthcoming).

The second issue regards the need for ASEAN to develop a common framework for its extra regional cooperation, particularly in forming FTAs. A common framework would make it easier for the various FTAs (or RTAs – regional trading arrangements) to become building blocks for or to be amalgamated into wider regional arrangements. More importantly, in so doing ASEAN can become a “hub” to drive the process in East Asia through the ASEAN+1 agreements. In addition, a common framework can help reduce tensions between ASEAN members. As some ASEAN members (e.g. Singapore) have move faster in developing FTAs, there is an additional, practical reason for having a common framework. The Singapore-New Zealand FTA has been referred to as a model for non-restrictive ROO. Bilateral FTAs involving ASEAN members should have harmonized ROOs along lines of Singapore-New Zealand.

Finally, for ASEAN to become a production base, it also needs to minimize business transaction costs by having similar rules and schedules of tariff reduction to ensure use of most efficient supplier. Most important in this regard is the Rules of Origin (ROO), which constitute one of the elements of a common framework. Restrictive ROO constrains sourcing of inputs. New ROO can also change sourcing decisions away from use of inputs from existing partners. In essence, a common ROO can facilitate the spread of full cumulation and the development of regional production networks. In its FTA with the US, Singapore has introduced two new approaches in calculating ROO that takes into account regional production networks. The first is the principle of outward processing that recognizes manufacturing chains and outsourcing. The second is the so-called Integrated Sourcing Initiative (ISI), allowing parts and components produced in Singapore’s neighboring countries as coming from Singapore, but this is limited to certain non-sensitive items only (IT components and medical devices).

Beyond trade in goods, a common framework also needs to be developed for services and investment, and perhaps also competition policy and IPR. Many of these elements form an integral part of the AEC project.

The many technical issues identified above should not overshadow the main task faced by the ASEAN countries, namely to develop the political will and the capacity to drive the process. If ASEAN fails to do so, potentially only China is in the position to be the main driver for the East Asian integration process. The region, the US, and the world may not be ready for this.

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