

integration process after World War II, and more recently, the Asian financial crisis prompted the East Asian countries to consider more seriously economic regionalism, and gave birth to the ASEAN+3 framework.

### **3. Trade Facilitation and the CJK FTA**

There is no common definition of trade facilitation in the existing international agreements. The definitions depend on the purpose, scope and direction of the agreements, and can naturally vary with each other. For instance, according to the Asia Pacific Economic Cooperation (APEC) in 2002, trade facilitation generally refers to the simplification, harmonization, use of new technologies, and other measures to address procedural and administrative impediments to trade. While the APEC's agreements are non-binding, the coverage of trade facilitation was wide and challenging. Compared to this definition, the WTO for instance narrowly defines trade facilitation as the simplification and harmonization of international trade procedures.

This section reviews and surveys the significant roles of trade facilitation both theoretically and empirically, and seeks possible application to a CJK FTA. The review looks first at the scope, coverage and economic rationale of trade facilitation in the regional trade/cooperation agreements. This also includes a brief review of the trade facilitation initiatives in the WTO and APEC. The second part of the section reviews the economic effects of various trade facilitation measures. The third part concludes the section with some consideration of trade facilitation in FTAs.

#### *Trade Facilitation: Its Revisited Roles*

Bilateral or regional cooperation has been the standard modality to facilitate international trade in the history of trade liberalization after the War. The multilateral approach in trade facilitation emerged as an active initiative only recently, since the new round of trade negotiation in the World Trade Organization (WTO). Until then, bilateral or regional initiatives had been the major arena of trade facilitation. However, such bilateral/regional cooperation in trade paid attention only to the natural bi-products of the regional trade agreements (RTAs), namely those which closely relate to the tariff enforcement, such as customs procedures and the cooperation between customs administrations.

For these two decades, a new trend in the strategy to liberalize international trade has appeared among the policy-makers as an emerging consensus: that is, to revisit the roles of trade facilitation and to use it more actively as one of the major vehicles to promote trade. The trade facilitation in the new context covers much wider areas of trade policies than ever, not limited to customs procedures. One of the notable examples in East Asia is the APEC, which regards trade facilitation as one of the two pillars to

promote trade in the region. Another is WTO Doha round, which gave an important role to trade facilitation. Furthermore, recent RTAs tend to include a wider scope of trade facilitation.

The emergence of the new trend had two backgrounds. One is that the traditional tools of trade liberalization, namely tariffication and tariff cuts, whose levels were already at low levels, relatively lost their power to further reduce the trade costs. The other is that new border management institutions and technologies attracted more attention to promote international trade. It was a natural development that the proliferated RTAs also put a focus on the trade facilitation agreements.

In several older FTAs in the world, trade facilitation resided in the chapters of customs procedure and administration in somewhat narrower definitions. Some more recent agreements, however, specifically include standards, technical regulations, conformity assessment procedures, and sanitary and phytosanitary (SPS) measures. The more recent agreements generally tend to cover more. Such expanded coverage includes service trade, modern customs management procedures, the adoption of international standards, and more formal and institutional mechanisms of cooperation. In addition, some bilateral/regional agreements include infrastructure development and cooperation, which cannot be covered by the multilateral trade negotiations by their nature. The wider and comprehensive coverage of the recent regional agreements provides an important lesson to the CJKFTA, in particularly in the clauses of non-conventional, non-customs-related types. Also, infrastructure development and cooperation is regional-specific and important for the trade between the three countries.

#### *Trade Facilitation Agenda in International/Regional Fora*

##### (1) APEC

The APEC adopted in 2001 the Shanghai accord, a policy package consisting of trade facilitation measures. This targeted a 5% reduction in trade transaction costs by 2006 for all the member economies. APEC agreed in Busan in 2005 to a further reduction of trade transaction costs by 5% in the period of 2007-2010. The second Trade Facilitation Action Plan of APEC (TFAP II) includes the four areas of Customs Procedures, Standards and Conformance, Business Mobility and Electronic Commerce (Table 3). Its most salient features include its non-binding nature and ambitions.

**Table 3: Menu of Actions and Measures of Trade Facilitation in APEC TFAP II**

<b>Customs Procedure</b>
1. Time Release Survey
2. Implement APEC Framework based on the WCO Framework of Standards
3. Simplification and Harmonization on the Basis of the Kyoto Convention
4. Paperless and/or Automation of Trade-related Procedures
5. Harmonization of Tariff Structure with the HS Convention
6. Appropriate, Transparent and Predictable Trade-related Procedures
<b>Standards and Conformance</b>
1. Align APEC Economies' Domestic Standards with International Standards; Implement Good
2. Achieve Recognition of Conformity Assessment in Regulated and Voluntary Sectors.
3. Technical Infrastructure Development
4. Ensure the Transparency of the Standards and Conformity Assessment of APEC Economies
<b>Business mobility</b>
1. Streamline And Standardise Procedures to Enhance Business Mobility
2. Enhance the Use of Information and Communications Technology
<b>Electronic commerce</b>
1. Removing barriers to electronic commerce
2. Speed the use of E-Commerce

(Source) APEC

(2) WTO

The WTO covers some limited components of trade facilitation. As discussed, by nature the focus of the WTO tends to relate to the movement of goods. Specifically, GATT Articles V, VIII and X are the related provisions which deal with freedom of transit for goods, fees and formalities connected with importation and exportation, and publication and administration of trade regulation, respectively.

In particular, in the process of WTO negotiation about Article VIII, Korea proposed the “Single Window” system, which allows parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfill all import, export, and transit related regulatory requirement. Japan and Korea proposed “Pre-arrival processing” as a measure to simplify release and clearance of goods, that requires the WTO members to maintain or introduce administrative procedures of customs and other relevant border agencies to accept and examine import documentation by trader prior to the arrival of the goods. China proposed to adopt modern custom practices, such as using risk assessment techniques and to carry out post-clearance audits. Risk assessment is defined as the systematic application of management procedures and practices providing customs and other relevant border agencies with the necessary information to address movements or

consignments in a way to prevent risk.

China, Japan and Korea have generally the same policy direction with the trade facilitation of the WTO negotiation, namely to expedite the movement, release, and clearance of goods. The three countries also share the idea of capacity building and technical assistance to developing countries to enable them to implement commitments.

#### *Trade Facilitation and Regional Trade Agreements (RTAs)*

There is increasingly a tendency toward the sophistication of provisions concerning trade facilitation in RTAs. But, the effective focus tends to be still placed on customs procedures and sometimes additionally on standards. Most often, the provisions of existing RTAs remain relatively unspecific in trade facilitation. In particular, clear and measurable objectives largely do not exist. The APEC Shanghai Accord, while the action is actually not classified as RTAs, is an exception.

Some of the trade facilitation provisions in RTAs/FTAs can be preferential, which provide the concession only to the partners of the agreements, while others may be non-discriminatory, Most-Favored-Nations (MFN) type. As frequently observed in the FTAs between the industrialized countries, the preferential trade facilitation measures can take a negotiation role to exchange concessions. But, researchers have found little evidence of trade facilitation provisions going against non-discriminatory principles. RTAs often reaffirm and reinforce the MFN principles and promote the formulation of international standards. Non-binding agreements like APEC have gone much further in promoting trade facilitation reform than binding agreements. Also, the trade facilitation in some FTAs takes the shape of cooperation. The broad perception behind such cooperation is that it generates positive externalities and economies of scale. The trade facilitation measures that create positive externalities take stronger characteristics of international/regional cooperation, as well as trade liberalization.

#### *Economic Effects of Trade Facilitation*

##### (1) Theoretical Review

A literature has grown to assess the economic impacts of trade facilitation measures. Two aspects of the economic impact exist in the facilitation of trade flows at the regional level. First, the static or efficiency gains of preferential trade facilitation emerge through better allocation of factors. Second, there will be impacts coming from imperfect competition with positive externalities and economies of scale.

### (1-1) Static Effects

Assuming that trade facilitation efforts are conducted on a preferential basis, it plays like reductions in tariff. The preferential and discriminatory reduction of trade barriers can lead to not only welfare-increasing creation of trade, but also trade diversion negative welfare effects where the loss of the domestic rent (away to foreign exporters) is not compensated by the benefits from lower prices due to the liberalization. These two opposite effects may possibly add up to a trade creation effect. As long as there are some domestically obtained rents, and the trade facilitation increases the weighted-average volume of trade, the total welfare will increase.

However, we also need to think about whether the implicit protection by Non-Tariff Barriers (NTBs) afforded to domestic industries by higher trade costs prior liberalization is generating domestic rents or not. Unlike the case of tariffs, where the rents are totally captured by the domestic authorities, there is no straightforward answer to the question. An example of the tariff-like NTBs is border fees such as consular or transit fees, which more than cover the real costs, and may be raised with a revenue objective. Lack of facilitation provides scope for such interests to surcharge importers and exporters or to provide poor quality services, resulting in delay, loss of goods, and corruption. In some instances such rents are directly created by the public sector. In other cases, it is indirectly the complexity and lack of transparency of administrative processes that favor the emergence of operators that can work out the system and charge fees for such services.

In many real situations of trade facilitation, however, there will be only small domestic rents and therefore the static effect of trade facilitation limits to the reduction of the import prices, i.e. trade cost effect only. This contrasts with tariff reduction where the risks of trade diversion are much higher. Trade facilitation lowers trade costs, and this benefits consumers of imported goods who pay lower prices. Also, trade facilitation is often non-discriminatory, which then results in eliminating all risk of trade diversion.

### (1-2) Effects from Imperfect Competition

Trade facilitation will bring about benefits through the realization of economies of scale and the creation of positive externalities. The impacts are especially important for regional trade facilitation. For example, duplication inevitably takes place in the procedures of regional trade because each country demands similar requirements. If national rules differ, the costs and uncertainty increase.

It would be particularly important in the regional context of East Asia that the formation of production networks heavily rely on the positive externalities in the region. Standards, recognitions and other

regulations, as well as customs procedures, had better be harmonized, streamlined and coordinated among the involving countries.

## (2) Empirical Studies

There are several studies assessing the effects of some components of trade facilitation measures, such as standards and customs procedures. General results of these empirical researches are that the economic benefits are unexpectedly large from the trade facilitation measures. More recently, standards and technical regulations are an increasingly prominent part of the international trade policy debates. As many of the least-developed countries have duty-free access to major developed-country markets, the trade effects of NTBs have assumed greater importance. Analysis has focused on how standards and regulations affect trade costs and export prospects for developing country firms exporting into developed markets. For instance, a study finds that testing procedures and lengthy inspection lower the exports of developing countries by 9 and 3 percent, respectively, and that standards reduce the likelihood of exporting to more than three markets by 7 percent. In a study on the effects of mutual recognition agreements for testing procedures and harmonization initiatives, it was found that the agreements are effective in promoting developing country exports. Another study finds that internationally harmonized standards exert less of an impact than non-harmonized standards on African exports. Overall, these studies demonstrate that standards have an effect on both the volume of exports from firms and the number of firms engaged in exporting.

There are a few references for estimating the overall welfare gains of trade facilitation, or removal of NTBs. An empirical study endeavors to quantify the impact of NTBs at the global level, using the GTAP model. This reference made use of an estimated dataset of *ad valorem* equivalent of NTBs, made by the World Bank. This dataset indicates that the NTBs are high. For example, the tariff and NTBs are 6.9% and 15.5% in Japan, 13.2% and 9.4% in China. Complete removal of NTBs invokes, according to their simulation, large welfare gains, comparable to large-scale tariff reductions, bringing about 1% of GDP to Japan, and 3% of GDP to China. The impacts are as large as estimated gains from CJK FTA tariff removal.

### *Trade Facilitation and Regional Free Trade Agreements*

As shown above, trade facilitation will bring about economies of scale and the creation of positive externalities. Often, this can be most efficiently made *regionally* and through *cooperation*. While global provision to facilitate trade is ideal, the complexity of interests and existing localization may make it unrealistic. Cooperation within a regional framework would be more pragmatic. In some cases, the optimal coverage should be confined to smaller groups of countries, i.e. regions. Regional

agreements in East Asia could have a much more active role in implementation, e.g. through mutual recognition, harmonization of standards and assistance, and eventually the sharing of resources and joint efforts to improve the trade supply chain.

In many cases, the FTAs appear to be the most suitable mechanism to achieve the benefits of trade facilitation in a region. Multilateral arrangement can also contribute to the delivery of the benefit of trade facilitation, and the solution may be best at first. But, as discussed above, a global agreement may take much longer negotiation time, and there may be much more complex conflicts/differences of interest among the members. In many cases, most of the benefit from trade facilitation remains within the region with large trade partners. Mutual recognition sometimes has this nature. Technical standards can be also harmonized most efficiently in a region.

## **Policy Recommendations**

### *Progressing Region-wide Liberalization Initiatives*

It would be worthwhile here to touch briefly on the present status of East Asian-wide trade liberalization initiatives, which have an important implication in the economic, political and diplomatic context with the CJK FTA. In East Asia, ASEAN tended to precede China, Japan or Korea in forming FTAs. As repeatedly pointed out, the trade liberalization initiatives between the three countries lag behind ASEAN. Three “ASEAN plus one” FTAs have been already formed. Two research studies on region-wide FTA, namely an East Asia Free Trade Agreement (EAFTA) among ASEAN+3 countries and a Comprehensive Economic Partnership for East Asia (CEPEA) among ASEAN+6 countries, have been finished and their final reports have been submitted to the AEM+3 Consultation and AEM+6 Working Lunch on August 15, 2009. On both occasions, the Ministers agreed to recommendations in the EAFTA and CEPEA Study and decided to establish four working groups and commence governmental discussions on rules of origin, tariff nomenclature, customs-related issues, and economic cooperation.

China, Japan and Korea, take dominant shares in East Asia, in terms of economic magnitude, population, and trade and investment. Huge amounts of direct investment have flowed from Japan and Korea toward ASEAN, as well as toward China. With the accumulation of external production assets, huge production networks have been established in East Asia. The networks in East Asia, however, will not work efficiently under the limited framework of “ASEAN plus ones”. Even at present, dominant share of trade and investment flows in the region are among China, Japan and Korea. The optimal formation of production network will be only possible when an FTA is achieved among China,