



# Pacific Economic Cooperation Council

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Papers

# **ASEAN Perspective on Promoting Regional and Global Freer Trade**

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## **1. Introduction**

ASEAN provides a “reality check” for regionalism in East Asia and the wider Asia Pacific region. It can suggest the kind of regional cooperation that can be promoted and the extent to which regional integration can be deepened.

Two points need to be made at the outset. The first is that the ASEAN region consists of a diverse set of countries, some of which have gained independence and sovereignty only within the previous generation. There are major gaps in their economic capabilities, and some have begun to open up economic and political systems only in the last decade. And yet, they have come together and committed themselves to the creation of an ASEAN Community. The second is that ASEAN has been engaged in efforts to promote cooperation and community building with other nations in the wider regional context of East Asia and the Asia Pacific region, both bilaterally through regular exchanges with Dialogue Partners and regionally in the ASEAN Plus Three (APT), the ASEAN Regional Forum (ARF), the Asia Pacific Economic Cooperation process (APEC), and even inter-regionally with Europe through the Asia Europe Meeting (ASEM) and Latin America through the Forum for East Asia Latin America Cooperation (FEALAC). These interactions have an impact on ASEAN cooperation, and have also resulted in dynamic developments in the wider region.

### **1a. ASEAN Style of Regionalism**

In Asia, ASEAN is the first attempt at regional community building. ASEAN is an on-going experiment in community building. It began in 1967 as a regional cooperation arrangement to promote welfare and peace in Southeast Asia. In that sense, it was based on some vision of regional order and regional community. Building this regional community began with some modesty. The regional arrangement sought to promote cooperation in the economic and social fields. This was understandable. The region had just opened up a new page in its history. Having gained independence and having experienced continued internal turmoil for about two decades, and more importantly, having ended political animosities, the five original members of ASEAN embarked on the path of community building by taking steps to learn more about each other and to learn to live together in harmony and peace.

It took these countries almost a decade to bring their leaders together for the first Summit meeting. That happened in 1976 in Bali. From then on, several concrete cooperation programs were introduced. They included the ASEAN Industrial Projects (AIP), the ASEAN Preferential Trading Arrangement (PTA), ASEAN Industrial Joint Venture (AIJV), and ASEAN Industrial Cooperation (AICO), to name some of the more important programs. ASEAN members began to learn how to cooperate and work together to achieve some common objectives. They were prepared to pool their resources, but they were unprepared to share their markets. Therefore, there were continuing tensions between “resource pooling” and “market sharing” in implementing and up-grading the cooperation programs. As a result, not much progress was achieved in the field of economic cooperation.

ASEAN’s founding fathers did not envision the economic integration of the region. In their view, that was a remote possibility, perhaps even an impossibility. However, gradually regional economies became more integrated. It was the remarkable economic growth of regional countries and gradual economic reform and opening up that greatly increased their economic interactions.

This was not a direct result of ASEAN economic cooperation programs. Rather, the region saw the working of “market-driven” integration.

This market-driven integration was not independent of developments in the political field and the intensification of ASEAN external relations. As the region turned into an ocean of stability and peace, thanks to the establishment of the regional forum, national governments were able to concentrate on national economic development. In the two decades until the middle of the 1990s, the region was growing at an average rate of 7 percent or more. This made the region even more attractive for trade relations with and investment from other parts of the world. The wave of Japanese foreign direct investment following the Plaza Accord in 1985 further deepened the development of regional production networks.

ASEAN has had established dialogues with its main trading partners since the late 1970s. These dialogues helped shape trade, aid and investment policies of ASEAN’s main dialogue partners in enhancing cooperation with ASEAN. In turn they also contributed to ASEAN’s increased diplomatic clout in the international arena.

Increased political cooperation amongst ASEAN members was a manifestation of the growing need to coordinate their views and policies in regard to international and regional strategic and political developments. The fall of Saigon changed the region’s political map, but the wave of “boat people” from Vietnam and the subsequent invasion of Cambodia by Vietnamese forces created potential sources of instability for Southeast Asia. ASEAN’s determination to help resolve the conflict in Indochina provided strong glue for ASEAN’s cohesion. ASEAN’s efforts were supported by the international community. Its international standing was at its height and signified ASEAN’s success.

It was felt, however, that the region needed to step up its economic cooperation to be able to effectively respond to economic globalization. There was much talk about the need to take “bold” decisions in the economic field. Eventually these led to the decision in 1992 to establish the ASEAN Free Trade Area (AFTA). Its boldness was the agreement to promote regional economic integration through resource pooling *and* market sharing. The ASEAN leaders produced a new kind of community building, namely one that stresses more on openness to each other, economically, socially as well as politically. ASEAN, it was argued, should have reached a state of maturity that allows them to be more open to each other. Due to growing interdependence, developments in one member country are likely to have a greater effect on the neighbors and the region as a whole. Thus came about the calls for “enhanced interaction” that allows for greater openness to comments and suggestions from fellow members on internal developments.

Another major move was the expansion of membership to finally complete the “One Southeast Asia” project. It was remarkable that in the middle of the 1990s ASEAN accepted the membership of Vietnam, its erstwhile enemy. A few years later, Laos and Myanmar were also brought in. Cambodia’s membership was delayed because of its internal developments. By the late 1990s, all Southeast Asian countries had become members of ASEAN, realizing the founding fathers’ dream. The broadening of ASEAN has become a challenge to ASEAN’s deepening. The new members have to take part in AFTA, but they are each given a longer time to implement the trade liberalization program. In reality, a two-tier ASEAN has emerged. This should not be a problem so long as they share a common goal.

ASEAN Vision 2020 was formulated to provide such a common goal. Its implementation was guided by the Hanoi Plan of Action (HPA). At the mid-term review of the HPA, it was felt that ASEAN members must have stronger commitments to realize the ASEAN Vision 2020. This led to

the proposal to deepen ASEAN economic integration towards an ASEAN Economic Community (AEC). By the time Indonesia hosted the Summit in Bali in 2003, ASEAN members agreed to create an ASEAN Community by 2020. As stated in the so-called Bali Concord II, the ASEAN Community consists of an ASEAN Economic Community, an ASEAN Security Community, and an ASEAN Social and Cultural Community. At the following Summit in Vientiane, leaders endorsed a Vientiane Action Program (VAP) to guide the process of community building in ASEAN for the next five years.

It has taken ASEAN nearly 40 years to come to the point where its members agree to form a Community (with a C) and not simply a community (with a c). They have about 15 more years to realize this vision. This remains a big challenge for ASEAN. It can be argued that this next phase in the integration process will be much more difficult.

The ASEAN model of community building, when contrasted to other experiences, is seen as having a distinct characteristic, namely its loose and open-ended process and its reliance on minimal institutional arrangements. These, plus the principle of consensus and the sanctity of national sovereignty, have characterized the so-called ASEAN way. However, the ASEAN way has undergone a modification. ASEAN's mode of operation has evolved from one that was based on full consensus to one that allows for the emergence of the coalition of the willing. Several members also believe that the sanctity of national sovereignty can no longer be used as a protection against irresponsible actions. A new ASEAN way may be necessary to realize the ASEAN Community.

The experiment will continue. To some extent the ASEAN experience and experiment have inspired community building in the wider region.

## **1b. ASEAN and Regionalism in Asia Today**

Regionalism has become a “booming” industry in Asia. There are many initiatives to form regional cooperation processes. They can be found at the inter-governmental level as well as at the non-governmental level, and they involve different subsets of countries in the region.

These initiatives have different objectives and manifestations: they may be aimed at strengthening functional cooperation in a variety of areas, developing regional mechanisms and institutions, promoting regional economic integration, as well as establishing a regional community.

It is important to again review the main principles for organizing the region that have emerged from the many discussions involving a wide range of regional stakeholders. They were clearly spelled out in the early years (1980s and 1990s), but in later years they have become blurred.

The first principle is “open regionalism”. Regionalism in Asia should not be an inward looking and discriminatory type of arrangement. When ASEAN formed AFTA, this principle appeared to have been violated. However, ASEAN never meant to create an inward-oriented regional market (an “internal ASEAN” market). ASEAN's trade is predominantly with non-ASEAN countries. Its main objective was to create a competitive regional economy that becomes attractive to global investors that will use it as a production and export platform for global markets. The principle of “open regionalism” in action in ASEAN is manifested in the reduction of MFN tariffs in parallel to or in some instances faster than the AFTA (CEPT) preferential tariffs.

APEC's liberalization agenda is also based on this principle. Liberalization, i.e. removal of trade barriers, is undertaken unilaterally by each APEC economy but in a concerted manner. This modality is known as “concerted unilateral liberalization”. There are views questioning the efficacy

of this modality. However, APEC is a non-binding process. As such, this modality is the only feasible one. If this process has not delivered on the expectations, this could well be due to the weak “peer” process (pressure) that should drive trade liberalization.

There are two views on the future direction of APEC economic cooperation. Those that are unhappy with the results so far have demanded a radical change towards a formal Free Trade Area of the Asia Pacific (FTAAP). The status quo group argues that the FTAAP is contrary to the principle of “open regionalism”-- and the political feasibility of the FTAAP proposal is highly problematic because the region is so diverse. It could well be that because a region-wide FTA is almost impossible, countries have resorted to sub-regional and even bilateral arrangements. These have proliferated lately, especially in Asia and the Asia Pacific region.

The second principle is that regional community building is much more than trade liberalization. It is a comprehensive undertaking and at least must include the following aspects: liberalization, facilitation, and development cooperation. In APEC these aspects have been translated into the TILF (trade and investment liberalization and facilitation) agenda and the ECOTECH (economic and technical cooperation) agenda. In the past few years two other agenda items have been added, namely human security and governance.

The focus, however, remains largely on trade liberalization. APEC’s progress is measured in terms of progress in its trade liberalization agenda. This is so because the goals of APEC community building have been narrowly defined as “achieving free and open trade and investment in the region by 2010 for the developed economies and 2020 for the developing economies” (Bogor Goals).

In ASEAN, the focus of economic cooperation is in the realization of the ASEAN Free Trade Area (AFTA) at the latest by 2015 (for some CLMV countries and certain agricultural commodities), while the goals and process towards an ASEAN Economic Community by 2020 remain ill defined.

It is reality that FTAs have become to be seen as the main manifestation of regional economic cooperation. They are being broadened to include other aspects, such as investment, competition policy, and a number of behind-border issues. These more comprehensive agreements are called “new age” agreements, EPAs (economic partnership agreements) or CEC (comprehensive economic cooperation) agreements.

They involve hard-nosed negotiations amongst participating economies as they revolve around exchanges of concessions. The whole atmosphere of “confidence and community building” is being reduced to a game of bargaining. The other aspects of cooperation have been overshadowed by this exercise in bargaining. This is not the idea of Asian community building that is characterized by sharing, solidarity, and mutual support.

East Asia community building, proclaimed to be different from that of APEC because it does not involve such countries as the United States, is in danger of falling into the same trap as other regional initiatives. It lacks innovative ideas to go beyond forming an FTA in developing its institutional identity.

ASEAN is pretty much in the forefront in developing comprehensive FTAs with a number of countries: China, Japan, Korea, India, and Australia and New Zealand. It is also exploring similar arrangements with the EU (European Union) and EFTA (European Free Trade Area). There is also the Enterprise for the ASEAN Initiative which will consist of bilateral FTAs between the US and selected ASEAN countries.

In addition, many Asian countries are forming bilateral FTAs with other countries inside and outside the region, causing problems of “managing an Asian noodle bowl”.

In theory ASEAN could play a significant role in maintaining coherence and consistency in all these initiatives because it is placed in the center stage. This is the main challenge for ASEAN as well as for the region as a whole, but ASEAN still lacks a clear and firm strategy to perform this critical role.

### **1c. Consolidating Individual ASEAN Countries' Approaches**

Members of ASEAN do not as yet have a single, common approach or perspective on how to develop their role in the development of regionalism in the wider region.

Singapore is perhaps the strongest advocate and practitioner of FTAs in ASEAN, followed by Thailand and Malaysia (see Table 1). At the same time, Singapore is also the most trade-dependent and most open economy in ASEAN and in the global economy; it has removed all MFN applied tariffs under the WTO and is a strong supporter of trade and investment liberalization under the WTO, APEC and ASEAN. Singapore is a living example of the benefits of an open economy and the ability to undertake structural reforms to meet the challenges of globalization. The strong government interest in bilateral FTAs in recent years has been spurred by the slow and uncertain progress in global and regional trade and investment liberalization under WTO, APEC and ASEAN.

The Singapore government views FTAs as building blocs towards global and APEC freer trade. Formation of bilateral FTAs among like-minded partners is seen as a way to avoid the problem in which the pace of trade liberalization is held back unnecessarily. It may also trigger other FTAs with its strategic partners like the case of Japan-Singapore EPA leading to the Japan-ASEAN initiative and the US-Singapore FTA leading to the US Enterprise for ASEAN Initiative. Singapore entered into several FTAs with APEC countries (New Zealand, Australia, Japan, US and South Korea in force, and Canada, Mexico, Chile under negotiation). Bilateral FTAs enable Singapore to widen and deepen the scope of economic cooperation to achieve targeted results, hence the features of FTA plus and WTO plus. The network of FTAs is also aimed at developing an integrated manufacturing center in the region; nurturing a knowledge-based economy; and driving the services hub. FTAs improved market access and Singapore's attractions for foreign investors.

In negotiating bilateral FTAs, Singapore is committed to “high quality”, going beyond the provisions of GATT Article XXIV and GATS Article V. Negotiations have generally been smooth not only because Singapore has no sensitive agricultural sector; it also does not protect its manufacturing and most of its services sectors, is prepared to open its economy to foreign investors and protect intellectual property rights, and is prepared to undertake continuing domestic reforms to further open up its economy.

In the case of Indonesia, FTAs in the form of RTAs, such as AFTA, are largely seen as a means to strengthen the region's position in the global economy as well as a part of regional community building. FTAs only figure in Indonesia's international economic strategy insofar as they help strengthen Indonesia's unilateral trade liberalization.

As of the beginning of 2006, besides AFTA, Indonesia is involved in only one FTA, namely with China, but through the China-ASEAN FTA. It is involved in ASEAN's FTA negotiations with Korea, India, and Australia-New Zealand CER. It is negotiating a bilateral FTA with Japan, aimed at concluding an agreement before the end of 2006, to be placed within the larger ASEAN-Japan framework agreement.

All these ASEAN-centered FTAs are seen by Indonesia as an extension of AFTA, to be strengthened by efforts to deepen integration in ASEAN towards an ASEAN Economic Community (AEC). For Indonesia, the rationale for forming these FTAs is the same as joining AFTA.

There have been talks and studies undertaken on Indonesia's bilateral FTAs with a number of developing countries (Chile, South Africa, Iran, Pakistan and Bangladesh) and with the United States and EFTA. FTAs with the developing countries are likely to be insignificant and shallow. No major attention and efforts are given to come to an agreement to begin negotiating them. An Indonesia-US FTA is in the agenda, but the two sides are far from agreeing on starting the negotiations. Recently, Indonesia de-emphasized its efforts towards a bilateral FTA with the US. Instead it puts serious efforts in strengthening its TIFA (trade and investment framework agreement) with the US.

Indonesia is a laggard and late-comer in the FTA game, but it is also not pursuing it pro-actively. How, for instance, will Indonesia play a role in pursuing an East Asia FTA (EAFTA)? There is not yet much talk in Indonesia about EAFTA. If other members of the ASEAN Plus Three are eager to develop EAFTA, Indonesia will go along. But Indonesia will not pro-actively promote EAFTA.

In the Indonesian policy community, the belief is that at the present moment, the region can only go so far as forming bilateral FTAs between ASEAN with each of the Plus Three partners, China, Japan, and Korea. The main preoccupation here is to have three separate and good agreements. The Indonesian business community is more sympathetic to an EAFTA and other FTAs, largely because of a concern that if Indonesia is not taking part in them, Indonesian exporters will be placed at a disadvantageous position vis-à-vis those in neighboring countries.

Only in the academic circles in Indonesia is there talk about ASEAN's important role in setting the agenda in the wider East Asian region to ensure that the three separate agreements have some consistency and coherence so that eventually they could be amalgamated into a single East Asia FTA.

Not much thought has been given so far whether India, Australia and New Zealand, who are participants in the EAS (East Asia Summit) and with whom ASEAN also is negotiating FTAs, will also be included in an EAFTA. More recently, in August 2006, Japan has proposed an EAFTA comprising of ASEAN Plus Six (China, Japan, Korea, India, Australia and New Zealand). However, it is desirable that the agreements with these countries would follow the same template.

Indonesia is unlikely to provide leadership in forming an East Asia FTA. However, if one were to be formed, Indonesia will make sure that it will preserve the basic "outward orientation" as is the case of AFTA, be an efficient agreement by minimizing distortions and unnecessary transactions cost (e.g. cause by the "noodle bowl" syndrome), and one that has built-in mechanisms to reduce gaps amongst its participants.

## **2. The ASEAN Model Revisited**

The ASEAN economic integration model is very different from that of NAFTA or EU. ASEAN was created in 1967 for political and security reasons and its founding fathers did not have economic integration in mind. The first efforts at economic cooperation, not integration, began in 1976 with a preferential trading scheme followed by industrial cooperation schemes. The first serious effort at economic integration was the decision in 1992 to form AFTA. It was established in response to external "threats" of globalization, the emergence of NAFTA and the EU Single Market, and the

rise of China.

## **2a. ASEAN Economic Integration in the 1990s**

The agreement establishing AFTA consisted of only a few pages, unlike the NAFTA document of over 1000 pages. It was more a political declaration of intent rather than a legal document and detailed roadmap of economic integration. Rules of origin had to be worked out and negotiated much later. There were no safeguard measures and no dispute settlement mechanism. AFTA covered only trade in goods, and had to be complemented by the ASEAN Framework Agreement on Services (AFAS) in 1995, and by the ASEAN Investment Area (AIA) in 1998. In 1997 ASEAN produced the ASEAN Vision 2020, with the aim to forge closer economic integration and narrowing the development gap between older and newer members. Each major step taken on ASEAN economic integration was taken in response to external threats and developments.

Critics point to the slow progress in ASEAN economic integration despite the numerous initiatives.<sup>1</sup> Many factors were recited as responsible --- lack of political will; individual ASEAN economies were more oriented and dependent for trade and investment on North America, Western Europe, Japan and the Asian NIEs, than on each other; lack of economic complementarity as ASEAN economies produce similar primary products and labor intensive manufactures and compete in the same export markets and for the same foreign investors; the wide development gap and industrial and technological competence among ASEAN members; and different commitments to an open economy.

ASEAN did not report AFTA to WTO under GATT Article XXIV but under the Enabling Clause for Developing Countries. As conceived in 1992, AFTA did not cover “substantially all trade” and did not plan to bring tariffs down to zero within 10 years.

The McKinsey study (2003) found that the many ASEAN initiatives have had limited impacts. For example: (i) intra-ASEAN trade share has not grown with implementation of AFTA; (ii) in 2000 less than 5 percent of intra-ASEAN trade made use of the AFTA tariff preferences<sup>2</sup>; (iii) wide divergences exist in consumer prices of common household products in the region; (iv) economic complementarity, such as in the electronics sector, has not been well leveraged; and (v) progress with removal of non-tariff barriers has been slow, particularly with regard to harmonization of standards, implementation of mutual recognition agreements, and streamlining of customs procedures.

## **2b. Towards an ASEAN Economic Community**

The ASEAN Economic Community (AEC) to be established by 2020 is to be a single market and production base with a free flow of goods, services, investments, capital and skilled labor. The AEC was motivated by deep concerns over intensified competition for markets and investments from the economic rise of China and India. In 2003 China received US\$53.3 billion in FDI compared to ASEAN's US\$19 billion. An integrated ASEAN with a market of over 500 million people should help retain the region's attractiveness as an FDI destination, and as a viable alternative to China for MNCs cautious of putting all their eggs in the China basket. As momentum for East Asian integration gathers steam, speeding up ASEAN regional integration takes on a renewed urgency.

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<sup>1</sup> See for example, Simon Tay, Jesus Estanislao and Hadi Soesastro (eds) (2003). *Reinventing ASEAN*. Singapore: Institute of Southeast Asian Studies.

<sup>2</sup> Possible explanations include declining margin of preference as MFN rates have also come down; lack of private sector awareness; lack of clarity in the application of rules of origin; problems with customs authorities; and lack of dispute settlement mechanism. Problems with rules of origin have led to a revision that incorporates change in tariff headings and product specific rules.



ASEAN economic ministers on 15 May 2006 advanced the AEC completion date to 2015 (instead of 2020). It is argued that, to remain in the driver's seat, ASEAN must be competitive and have certain leverages, otherwise focus will be more on China and India.

As laid out in the Vientiane Action Program (VAP) for 2006-2010, activities to realize the AEC focus on 4 components: (i) intensify current economic initiatives and accelerating the integration of 11 priority sectors; (ii) remove, as far as possible, barriers to the free flow of goods, services, skilled labor, and a freer flow of capital by 2010; (iii) develop measures to attract investments, liberalize and facilitate trade in goods, promote regional trade in services, upgrade the competitiveness of ASEAN small and medium enterprises (SMEs), and strengthen the ASEAN dispute settlement system; and (iv) pursue strong external economic relations through free trade areas and comprehensive economic partnerships.

Prior to the Bali Concord that establishes the AEC, two proposals were put forward for the AEC in 2003. The first proposal by ISEAS<sup>3</sup> envisages the AEC as an "FTA plus" arrangement that covers a zero-tariff ASEAN FTA and some elements of a common market (free movement of capital and skilled labor). It argues that, given the different degrees of openness and stages of economic development among ASEAN countries, forming a customs union would be extremely difficult to achieve by the 2020 deadline. The proposal envisages the AEC to have the following characteristics ---free movement of goods, services, investments and capital, including zero-tariff FTA and elimination of all non-tariff measures (NTMs); an attractive regional production platform that would be a magnet for FDI; free movement of skilled labor and creative talent; harmonization of customs procedures and minimization of customs requirements; harmonization of standards that are consistent with international standards; and a well developed institutional and legal infrastructure to facilitate the economic integration of ASEAN.

The second proposal by ASEAN-ISIS<sup>4</sup> adopts a "common market minus" approach, that is, creation of a fully integrated market (common market) by 2020 but taking into account areas where members reserve deeper integration for a larger stage. A common market has complete free flows of trade, including internal trade (as in a customs union) as well as free mobility of labor and capital. Full mobility of labor involves the right to reside and seek employment in all member countries, and mutual recognition of professional and technical qualifications. Full capital mobility requires an absence of exchange controls and full rights of establishment for firms in all countries. Credible removal of tariffs may require policy harmonization or common policies in taxes, wages, prices etc. It may require common rules governing competition and monopoly as well as environmental regulations.

The High Level Task Force (HLTF)<sup>5</sup> on Economic Integration recommended that: the AEC should be: (i) the end goal of economic integration as outlined in the ASEAN Vision 2020; (ii) characterized as a single market and production base, with free flow of goods, services, investment and skilled labor, and freer flow of capital by 2020; and (iii) approached on a progressive basis with clear timelines by strengthening existing initiatives and building new initiatives to enhance economic integration. It is unclear what is meant by "a single market", since it does not include a common external trade policy or customs union.

#### ***Strengthening of current initiatives:***

- *Rules of origin:* By end-2004, finalize the improvement to the CEPT Scheme Rules of Origin:

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<sup>3</sup> ISEAS Concept Paper on the ASEAN Economic Community.

<sup>4</sup> ASEAN-ISIS Report on Towards an ASEAN Economic Community.

<sup>5</sup> Recommendations of the High-Level Task Force on ASEAN Economic Integration, annex to the Bali Concord II, 7 October 2003

by making it more transparent, predictable and standardized and adopting substantial transformation as alternative criteria for conferring origin status.

- *Non-tariff measures:* Ensure transparency of NTMs and eliminate those that are barriers to trade ---- Establish the ASEAN Database of NTMs by mid-2004; set clear criteria to identify measures that are classified as barriers to trade by mid-2005; set a clear and definitive work program for the removal of the barriers by 2005; adopt the WTO agreements on Technical Barriers to Trade, Sanitary and Phytosanitary and Import Licensing Procedures, and develop implementation guidelines appropriate for ASEAN by end-2004.
- *Customs:* Ensure full implementation of the Green Lane system for CEPT products at entry points of all member countries by 2004; adopt WTO agreement on Customs Valuation and develop implementation guidelines appropriate for ASEAN by end-2004; adopt service commitment by ASEAN customs authorities; and adopt the Single Window approach including the electronic processing of trade documents at national and regional level.
- *Standards:* Accelerate the completion and implementation of the MRAs for the 5 identified priority sectors (electrical and electronic equipment, cosmetics, pharmaceuticals, telecommunications equipment, and prepared foodstuff) within 2004/05, and other sectors with significant potential for trade; set specific targets for the harmonization of standards and technical regulations to trade focusing on sectors with significant trade value and those with potential for trade in the future; develop ASEAN technical regulations, where possible, for national applications.
- *Trade in services:* Set clear targets and schedules of services liberalization for each sector and each round towards achieving free flow of trade in services and AEM to provide specific mandate in every round of service negotiations, with end-date to achieve free flow of trade in services earlier than 2020; accelerate services liberalization in specific sectors earlier than end-date by countries which are ready, through application of ASEAN-X formula<sup>6</sup>; complete MRAs for qualifications in major professional services by 2008 to facilitate free movement of professional/skilled labor/talents in ASEAN; promote the use of ASEAN professional services through establishment of “professional exchange” by 2008; recognize the AEM as the coordinator for services liberalization across all sectors; and each country to be represented by senior officials who are authorized to negotiate on behalf of the government. (At the AEM in September 2005, it was agreed to push forward the end-date for liberalization of all services sectors to 2015, with flexibility allowed for some sub-sectors. Senior officials were tasked to map out a roadmap to open up services sectors in all modes of supply. )
- *Investment:* Speed up the opening of sectors currently in the sensitive list to TEL, using the ASEAN-X formula, beginning 2004; encourage and promote companies to relocate within ASEAN and where appropriate, special incentives should be given; institute a mechanism to monitor the specific activities and timelines undertaken by each country vis-à-vis their submitted planned actions/activities on annual basis; establish a network of ASEAN free trade zones so that companies could structure their manufacturing processes across different ASEAN countries to take advantage of their comparative strengths and in the process increase intra-ASEAN trade and investment, and special marketing efforts should be undertaken for ASEAN-based companies; and undertake more effective joint ASEAN facilitation and promotion measures and develop new sources of inward FDI, particularly from potential countries such as China, India and Republic of Korea.

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<sup>6</sup> ASEAN may also use the 2+x approach where 2 member countries that are ready to integrate certain sectors can go ahead first. However this approach could be problematic as it does not require a consensus among all member countries (unlike the ASEAN minus X principle). The other concern is that the bilateral nature of this process could lead to a fait accompli where the third “plus X” country may be bound by whatever has already been agreed by the first 2 countries.

- *Intellectual property rights*: ASEAN IPR cooperation beyond trademarks and patents by including cooperation in copyrights information exchange and enforcement by 2004.
- *Capital mobility*: To facilitate trade and investment flows, expedite the implementation of the Roadmap for Integration of ASEAN in Finance.

***New initiatives:***

- *Priority integration sectors*: Fast tracking of trade and investment liberalization in specific sectors may help build capacity and constituency for further liberalization. ASEAN identified 11 sectors for accelerated tariff elimination and trade and facilitation measures. Beginning in 2004, a roadmap is developed for each priority sector and implemented with the active involvement of the private sector. Possible measures proposed for the goods sectors --- zero internal tariffs, immediate removal of barriers to trade, faster customs clearance and simplified customs procedures, accelerated development of MRAs and harmonization of product standards and technical regulations. Integration of services sectors include accelerated liberalization of these priority sectors by 2010, accelerated development of MRAs, and promote joint ventures and cooperation including in third country markets. Facilitate mobility of business people and tourists through visa exemption for intra-ASEAN travel by ASEAN nationals by 2005; harmonizing the procedures for issuing visas to international travelers in ASEAN by 2004; and developing ASEAN agreement to facilitate movement of business persons and skilled labor and talents by 2005.
- *Institutional strengthening*: Streamlined the decision making process and ensure effective implementation of ASEAN economic initiatives. These include: (i) Decision-making process by economic bodies to be made by consensus, and when there is no consensus; (ii) by end-2004, establish an effective dispute resolution system; and (iii) enhance the capability of the ASEAN Secretariat to conduct research and analytical studies related to trade, investment and finance.
- *Development and technical cooperation*: To address the development divide and accelerate the economic integration of CLMV.

**2c. Progress in Trade and Investment Liberalization**

***Trade in goods liberalization***

AFTA originally had a timeframe of 15 years, from 1993, to reduce tariffs to the 0-5 percent target. ASEAN has progressively advanced AFTA's completion date and moved the tariff target to zero. The completion date was first advanced to 2003 and, in response to the 1997-98 financial crisis, was advanced further to 1 January 2002. As latecomers, the completion dates for CLMV were set at 2006 for Vietnam, 2008 for Laos and Myanmar, and 2010 for Cambodia. The zero-tariff target is to be achieved by 2010 for ASEAN6 and 2015 for CLMV. Under the AEC, the 11 priority sectors have been identified for accelerated integration<sup>7</sup> cover about 4,000 tariff lines or about 40% of the total tariff lines in ASEAN. As compared to AFTA deadlines of 2010 for ASEAN6 and 2015 for CLMV, tariffs will be eliminated on 85% of the products in the priority sectors by 2007 and 2012 respectively.

For ASEAN6, by January 2005, 99% of all products in the CEPT<sup>8</sup> Inclusion List have their tariffs reduced to the 0-5% target, 64.2% have achieved zero tariffs, all CEPT products have been transferred into the Inclusion List, and the average tariff brought down to 1.87% as compared to 12.76% in 1993. However, intra-ASEAN share of ASEAN's total exports remained stagnant, with 22.5% in 2004 as compared to 21.1% in 1993. For CLMV, 87.2% of the products have been moved

<sup>7</sup> These are agro-based products, air travel, automobile products, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparel, tourism, and wood-based products. A 12<sup>th</sup> priority sector, logistics, has since been included.

<sup>8</sup> The Common Effective Preferential Tariff is the main instrument to implement AFTA.

into the CEPT Inclusion List and tariffs on 71.05% have been brought down to the 0-5% level.

As tariffs come tumbling down in AFTA, more emphasis is being placed on trade facilitation, especially customs barriers, electronic processing of trade documents, harmonization of product standards and technical regulations, and MRAs, including for test reports and certification.

### ***Trade in services liberalization***

Services trade liberalization under AFAS has been very slow and efforts are being made to accelerate it. Two flexibilities were introduced in 2003. First is the faster liberalization for modes 1 and 2 (cross-border supply and consumption abroad), and slower liberalization for modes 3 and 4 (commercial presence and presence of natural persons). Second, an “ASEAN minus X” formula allows two or more ASEAN countries to proceed first, with other members joining at a later date. Mutual recognition agreements (MRAs) are being negotiated to facilitate movement of experts, professional and skilled workers in ASEAN in engineering, architectural and accounting services, as well as nursing and medical practitioners. There are also measures to facilitate intra-ASEAN travel for ASEAN nationals and movement of business people, experts, professionals and talents.

### ***Investment liberalization***

The AIA aims at making ASEAN a competitive and liberal investment area. It would enable investors to leverage on the various complementarities of the ASEAN region to improve business efficiency and lower costs, adopt regional business strategies and establish network operations. Originally confined to the manufacturing sector, investments under the AIA were later opened also to agriculture, mining, forestry and fishery sectors and services incidental to these sectors. ASEAN members are committed to gradually eliminate investment barriers, liberalize investment rules and policies, and grant national treatment to ASEAN investors by 2010 and to all other foreign investors by 2020. The end-dates for phasing out the temporary exclusion lists in manufacturing were set at January 2003 for ASEAN6 and Myanmar, and January 2010 for CLV countries; for the other designated sectors, they are January 2010 for ASEAN6 and Cambodia, 2013 for Vietnam, and 2016 for Laos and Myanmar.

## **3. ASEAN Plus Agreements As Building Blocks?**

ASEAN is currently negotiating ASEAN Plus One agreements with China, Japan, Australia-New Zealand, India and South Korea. They are all known as comprehensive agreements as they encompass trade in goods, trade in services, investment, trade facilitation, intellectual property, competition policy, government procurement, and wide-ranging areas of economic and functional cooperation. They are all initiated by ASEAN’s trading partners and make ASEAN a de facto hub in East Asia. There is also the ASEAN Plus Three framework and the proposal for an East Asia FTA.

### **3a. ASEAN Plus Agreements**

The ASEAN Plus and bilateral FTA initiatives proliferated in the post-1997 period. Before that, there was only ASEAN and AFTA. There are a number of driving forces.

- *1997-98 Asian financial crisis*: The Crisis demonstrated the close economic and financial interdependence among Southeast and Northeast Asian economies. There was tremendous disappointment with the role of the IMF and the Washington consensus. The ASEAN Plus Three monetary and financial cooperation helps maintain regional economic stability and resilience. The Crisis also provided the forum for formal dialogue between Southeast Asia and Northeast Asia and to the emerging idea of an East Asia economic bloc.
- *Defensive reactions*: The strong interest in regional and bilateral FTAs was a defensive reaction

to the competition from globalization, the slow progress in the WTO, and growing regionalism in the Americas and in Europe. The emergence of these continental blocs could impinge on ASEAN competitiveness in export markets and in attracting foreign investments.

- *Responding to the economic rise of China and overtures from major trading partners:* The economic rise of China and its WTO accession is changing the global and regional trade and investment landscape. There is a growing desire and need to strengthen economic relations with China, the emerging economic powerhouse in Asia. In 2001, at the ASEAN-China Summit, China proposed the establishment of an ASEAN-China FTA within 10 years. This triggered a domino effect on Japan, South Korea, India, and Australia-New Zealand. Japan reacted to the China challenge to its dominant position in Southeast Asia. With Japan and China seeking FTAs with ASEAN, South Korea could not afford to be left behind. India saw the opportunities with ASEAN to expand its “Look East Policy”. Australia and New Zealand CER (Closer Economic Partnership) have been pushing for closer economic relations with ASEAN for some years but did not succeed until political relations thawed. US President Bush, during the APEC Summit in October 2002, announced the Enterprise for ASEAN Initiative, which will entail a series of bilateral FTAs with individual ASEAN countries. The latest “domino” is the proposed ASEAN-EU initiative<sup>9</sup>, seen as the EU response to being sidelined by ongoing ASEAN negotiations with China, Japan, South Korea, India and the US.

### ***ASEAN-China Framework Agreement and Comprehensive Economic Cooperation***

Economic relations between ASEAN countries and China developed only after the end of the Cold War, although historically China has had long trade and people relations with Southeast Asia. China first proposed an FTA with ASEAN in November 2000 as part of a process of confidence building. It seeks to allay ASEAN concerns over the China challenge in export markets and in attracting foreign investment, as well as to access ASEAN's sizeable regional market and energy and raw material resources. For ASEAN, it will force the group as a whole to have a constructive engagement with China. ASEAN also views China as a rapidly growing market for its products and services (including tourism), and as a new engine of growth. The deal was made attractive for ASEAN with the Early Harvest Program and with a special and preferential treatment and flexibility offered by China for CLMV. The China proposal will also bring ASEAN back to center-stage. Thus ASEAN did not hesitate to accept China's offer.

The *Framework Agreement on ASEAN-China Comprehensive Economic Cooperation* (CEC) was signed in November 2002. Many of its components remain to be negotiated.

- An *Early Harvest Program* (EHP) of tariff reduction and elimination, primarily in agricultural goods, was implemented on 1 January 2004 for 3 years. There is an Exclusion List and different time frames between ASEAN6 and CLMV. The Philippines delayed its participation in the EHP.
- The *Agreement on Trade in Goods* was implemented in June 2005. It provides for tariff reduction and elimination along 2 tracks. For products on the normal track, tariff reductions would be completed by 2010 for ASEAN6 and China, and by 2015 for CLMV. For products on the sensitive track, the tariff reduction schedule is determined by mutual agreement. The rules of origin are based on 40 percent value added. Countries are committed to abide by provisions of WTO disciplines on NTM, TBT, SPS, subsidies and countervailing measures, anti-dumping measures and IPR, GATT Article XIX and WTO Agreement on Safeguards.
- Each ASEAN state agrees to recognize China as a full market economy<sup>10</sup>

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<sup>9</sup> Officials from ASEAN and EU have held 3 rounds of talks. Myanmar's poor human rights record might be a problem. The ASEAN-EU Vision Group has been given the mandate to study and submit recommendations on the future of ASEAN-EU economic relations including possibility of an ASEAN-EU FTA.

<sup>10</sup> ASEAN will not apply Sections 15 and 16 of the Protocol of Accession of the PRC to the WTO and Paragraph 242 of the Report of the Working Party on the Accession of China to WTO.

- The Agreement on Dispute Settlement Mechanism has also been signed, while negotiations on services and investment are ongoing.

### ***ASEAN-Japan Framework Agreement and Comprehensive Economic Partnership***

In recent decades, Japan has been a major trade and investment partner of Southeast Asia and its leading ODA donor. Japanese Prime Minister Koizumi proposed an economic partnership agreement with ASEAN in January 2002, during his visit to Singapore for the signing of the Japan-Singapore economic partnership agreement, and soon after China's FTA proposal to ASEAN. Japan was concerned over China's growing influence in Southeast Asia, and a formalized relationship would help consolidate its economic relations with ASEAN. In turn, ASEAN recognizes Japan as the second largest economy in the world and its role as the regional engine of growth in recent decades. The formalized partnership will anchor Japanese economic interests in ASEAN and balance the rise of China. For the less developed ASEAN economies, Japan is also the largest donor of technical and development assistance.

In November 2002, ASEAN and Japan signed the *Joint Declaration* to develop a framework agreement and provide for separate bilateral agreements with individual ASEAN economies. The *Framework Agreement for Comprehensive Economic Partnership* was signed at the ASEAN-Japan Summit in October 2003.<sup>11</sup> The Framework laid out the following principles ---comprehensive coverage of countries and of sectors; special and differential treatment for ASEAN states, reflecting their lower economic development levels, and greater flexibility for CLMV; flexibility for sensitive sectors of ASEAN and Japan; early implementation of cooperation in areas which could provide more immediate benefits, such as technical assistance and capacity building to ASEAN, especially for CLMV; trade and investment promotion and facilitation; trade and investment policy dialogue; business sector dialogue; mobility of business people; trade data compilation and exchange; facilitation and cooperation programs covering a wide field.

The ASEAN-wide comprehensive economic partnership (CEP) including FTA should be realized by 2012 for ASEAN6 and 2017 for CLMV. Japan has insisted that the ASEAN-wide agreement should be a "single undertaking". It will take account of the achievements of bilateral negotiations and the further progress of the ASEAN integration process. Schedules of liberalization concessions between Japan and individual ASEAN countries in the bilateral agreements would not be re-negotiated in the ASEAN-wide CEP, and the bilateral schedules of liberalization concessions would be annexed to the ASEAN-Japan CEP Agreement.

Negotiations on ASEAN-Japan FTA launched in early 2005 stalled and resumed in April 2006.<sup>12</sup> The biggest obstacle to negotiations with ASEAN is Japan's resistance to liberalization of agricultural and labor markets.<sup>13</sup> It wants to maintain its high import tariffs for farm products,

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<sup>11</sup> The objectives of the Framework cover: strengthen economic integration through the creation of a comprehensive economic partnership (CEP); enhance the competitiveness of ASEAN and Japan in the world market through strengthened partnership and linkages; progressively liberalize and facilitate trade in goods and services as well as create a transparent and liberal investment regime; explore new areas and develop appropriate measures for further cooperation and economic integration; facilitate the more effective economic integration of CLMV and bridge the development gap among ASEAN members .

<sup>12</sup> A stumbling block was Japan's proposed plan to remove trade barriers on more than 90% of goods between the two sides. However, ASEAN proposed a 100% tariff cut in all of the goods from the grouping to Japan, while seeking some exceptions in goods from Japan. ASEAN which has been in FTA talks with China, South Korea, Australia and New Zealand have created tariff-cutting frameworks in their respective negotiations. In those frameworks, the parties can unilaterally declare a limited number of items to be excluded from trade liberalization so that politically sensitive goods would be immune to drastic tariff reductions. But Japan does not want to adopt this practice and instead is seeking to discuss tariff elimination of each item by exchanging requests and offers.

<sup>13</sup> Japan's prototype FTA/EPA was with Singapore and had negligible agricultural content. Agreement with Mexico

including the politically sensitive rice, to shield weak and uncompetitive domestic farmers from cheap imports. This has resulted in Japan lagging behind China in the race to clinch FTAs with trading partners. Both sides agreed to incorporate common factors found in Japan's bilateral FTAs with ASEAN economies into the ASEAN-wide FTA. Then they will take up matters that need work in a ASEAN-wide format. The FTA talks are aimed to conclude in March 2007. Japan has decided to focus on the FTA and tariff reduction and elimination.<sup>14</sup> Japan's strategy is to negotiate with the more advanced ASEAN economies first. Bilateral agreements with Singapore and Malaysia have been signed in November 2002 and 2005 respectively, while negotiations with Philippines, Thailand and Vietnam are ongoing. ASEAN countries that have not concluded bilateral agreements with Japan will negotiate concessions bilaterally. The ASEAN-wide CEP will essentially be an umbrella agreement for the separate bilateral FTAs, in contrast to the approach adopted with the ASEAN-China initiative

### ***ASEAN-Korea Comprehensive Economic Cooperation***

At the ASEAN-Korea Summit in October 2003, Korean President Roh proposed a comprehensive partnership with the possibility of establishing a free trade area (AKFTA). At the Summit in November 2004, a joint ASEAN-Korea *Declaration on Comprehensive Cooperation Partnership* agreed that (i) negotiations for the AKFTA commence in 2005 and be concluded within 2 years, (ii) that ASEAN6 and Korea eliminate tariffs for 80 percent of all products by 2009, as a key milestone in the realization of the AKFTA, which will have similar features of other ASEAN FTAs in its comprehensiveness and provision for flexibility for CLMV.

The *Framework Agreement on Comprehensive Economic Cooperation* was signed on 13 December 2005 and came into force on 1 July 2006.

- Korea and ASEAN6 will start cutting tariffs from July 2006 and the CLMV at a later date. Korea and ASEAN6 will eliminate tariffs on 90% of their products by 2010, with flexibility until 2012 for a certain number of products. Korea and each ASEAN country may choose up to 40 items that could be excluded from tariff reductions. Talks hit a snag over tariffs on food products for ASEAN and automobiles, steel and mobile phones for Korea. Thailand, the world's top rice exporter did not sign the agreement, partly over its dispute with Korea regarding barriers on certain agricultural products under its sensitive items, including rice.<sup>15</sup> Korea wants to put rice on its protected list but Thailand has objected and so the Thais have asked for more time to sign. Thailand decided to step aside rather than hold the rest of ASEAN back. Tariffs on 97 percent of about 4,000 categories of goods will be cut by 2010, with the rest by 2016.
- Negotiations on liberalization of trade in services and investments would only start rather than conclude by end-2006 as originally anticipated.
- ASEAN has agreed to treat goods produced at the Kaesong Industrial Complex in North Korea as made-in-South Korea.<sup>16</sup>

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allowed some access for Mexican pork in Japan but the agriculture issue will have to be confronted more directly with the Philippines, Thailand, Indonesia and Korea.

<sup>14</sup> In March 2006, the Japanese government decided to expedite FTA negotiation process by changing its policy of giving priority to conclude EPA over an FTA, noting that an EPA negotiation is more time consuming as it is more comprehensive and include investment, intellectual property and dispute settlement issues. Japan was prompted to speed up the process, after China signed a deal with ASEAN, while Korea reached a basic agreement.

<sup>15</sup> Negotiations have also been stalled by Thailand's political crisis, as the current government has no mandate to make decisions after the April 2 snap polls were annulled.

<sup>16</sup> The Kaesong Industrial Complex is jointly run by South and North Korea. It has figured highly in all of South Korea's FTA negotiations since the complex went into operation in 2004. South Korea wants to help North Korea open to the world and expand inter-Korean cooperation. But the matter causes problems because it conflicts with WTO regulations on tariff exemptions on goods produced in third countries. The 9 October 2006 North Korean nuclear test has occasioned a change in South Korea's policy towards the North and this would affect the Kaesong Industrial Complex.

### ***ASEAN-India Comprehensive Economic Cooperation***

A cornerstone of India's "look East" policy, born partly of a desire to catch up with China's high profile in the region, was closer and rapid economic integration with ASEAN. Indian Prime Minister Vajpayee offered ASEAN a trade pact during the ASEAN-India Summit in November 2002, one year after China's offer to ASEAN. Subsequent Indian Prime Minister Singh's vision of a pan-Asian community is considered to be a natural extension of the FTA that India has with ASEAN. To leverage this "*arc of advantage*", (ASEAN plus China, Japan, Korea and India), an FTA with ASEAN is expected to get operational in 2007. Strategically, India cannot afford to be left behind by not signing an FTA with ASEAN, as India has been trying hard to be a member of some major Asian trading bloc.

A *Framework Agreement for a Comprehensive Economic Partnership* was signed in October 2003 and entered into force on 1 July 2004. It envisaged that tariff concessions should cover at least 80 percent of the trade between ASEAN and India. Tariff reductions were set to start by 1 January 2006 and be concluded by ASEAN5 (excluding Philippines) and India by December 2011, and Philippines and CLMV by 2016. The number of products listed in the sensitive track should be subject to maximum ceiling to be mutually agreed; products listed in sensitive track should have their respective MFN applied tariff rates progressively reduced/eliminated within timeframes to be mutually agreed. The negotiations to establish the ASEAN-India FTA (AIFTA) have not progressed well.

- The implementation date of the ASEAN-India FTA was postponed from 1 January 2006 to 1 January 2007 and the Early Harvest Program has been dropped.
- Considerable differences exist over rules of origin. ASEAN rejected India's proposal of twin criteria for determining the rules of origin, namely the 40 percent domestic value added plus change in tariff heading. Eventually both sides agreed to at least 35 percent domestic value added plus change in tariff heading.
- Negotiations also ran into difficulties over India's resistance to tariff cuts on a range of products. ASEAN is one of the most efficient global producers of rice, palm oil, plantation crops (like coffee, tea) and spices (like pepper). India has high agricultural tariffs in the range of 70-100%. Many of the Indian producers are small and marginal farmers. India is also worried about imports of manufactures from Thailand. Initially India presented an exclusion list of 1,414 products (including textiles, rice, vegetable oil, and petroleum products) that represented 44 percent of ASEAN's total exports to India, of which vegetable oil and petroleum products accounted for 27 percent of ASEAN total exports to India in 2004. Malaysia is concerned that if palm oil, tea, pepper and textiles are on India's negative list, this would affect 80 percent of its total exports to India. As a result of ASEAN protests, the Indian negative list has been pruned from 1,414 to 850. However, Sonia Gandhi has written to Indian Prime Minister Singh cautioning him over the issue of farm imports in FTAs. To protect Indian farmers, the Indian government proposed to impose tariff rated quotas for the import of palm oil from Malaysia and Indonesia; tea, coffee and pepper from Vietnam. But ASEAN negotiators so far are not willing to accommodate.
- India also wants to balance tariff concessions on goods with market access to ASEAN's services sectors where India has recognized global comparative advantage. Many ASEAN countries are not very keen to give India this advantage.

### ***Synthesis and Assessment***

Collectively, ASEAN has a population of about 550 million, and a combined nominal GNP of US\$630 billion (2003 figures). However, it does not yet have an integrated market. But even an integrated ASEAN has a much smaller nominal GNP than either NAFTA or EU. Hence ASEAN

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has to be outward looking and has readily accepted proposals for FTAs from its major trading partners, while some ASEAN countries are negotiating bilateral FTAs. Table 2 shows the comparative sizes of ASEAN and its FTA partners. By population size, ASEAN Plus Three has 2 billion people, ASEAN-China has 1.8 billion people and ASEAN-India has 1.6 billion people, while ASEAN-CER (Australia and New Zealand) adds minimally to the ASEAN population size. A better determinant of market size is GNP. ASEAN-US has the largest GNP (US\$10.7 trillion in 2002), followed by ASEAN Plus Three (US\$6.5 trillion), ASEAN-Japan (US\$4.8 trillion) and ASEAN-China (US\$1.8 trillion). While US, Japan, and China have larger economies than the collective ASEAN10, the economies of India, South Korea and CER are smaller. Another indicator of market size is the volume of trade. The largest is ASEAN-US, followed by ASEAN Plus Three. The trade volume of Japan is comparable to ASEAN, but the trade volume of South Korea, CER and India are considerably smaller.

The various comprehensive economic partnership/cooperation initiatives have been dubbed as “FTA-plus” and “WTO-plus”, all with a FTA core.

- A domino effect is evident. China’s proposal of an agreement with ASEAN, was rapidly followed by similar offers of comprehensive economic partnership/cooperation from Japan, Korea, India, and Australia-New Zealand, with the latest being the EU. Japan chose both an ASEAN-wide framework umbrella and bilateral FTA agreements with individual ASEAN countries. Japan had a bilateral agreement with Singapore prior to the ASEAN-wide initiative, but followed up with bilateral negotiations with Malaysia, Indonesia, Thailand, Philippines and Vietnam. Likewise, Korea and India have bilateral agreements with Singapore before embarking on the ASEAN-wide agreements. China embarked on a bilateral agreement with Thailand after initiating the ASEAN-wide agreement. At this stage of the game, it is unclear what the relationship is between the ASEAN-wide agreements and the bilateral agreements, in particular relating to rules of origin and sensitive lists. In contrast, the US under the Enterprise for ASEAN Initiative is engaged only in bilateral agreements, with an agreement with Singapore preceding the EAI announcement and now with several negotiations ongoing.
- The scope of the partnership/cooperation agreements extends beyond trade liberalization in goods to include liberalization of trade in services and investment; trade and investment facilitation; government procurement; intellectual property protection; competition policy. They also include economic and technical cooperation over broad areas --- cooperation in the development of agriculture, industry, fishery, forestry, energy; human resources; infrastructure; small and medium enterprises; science and technology, information and communications technology; and labor and environment. Additionally, they include special and differential treatment, flexibility, and capacity building for the less developed CLMV.
- Framework agreements were reached prior to negotiations on the various components of the comprehensive partnership/cooperation in trade in goods, trade in services, investment, and dispute settlement mechanism. Only the ASEAN-China agreement has implemented an Early Harvest Program, while the ASEAN-India agreement abandoned such an intention. The trade in goods agreement is usually negotiated and implemented first, while agreements on services and investment are ongoing.
- There are varying implementation and end-dates for tariff reduction/elimination in trade in goods:
  - AFTA: Implemented in January 1993. End-date of 2010 for ASEAN6 and 2015 for CLMV.
  - ASEAN-China: Implemented in June 2005. End-date of 2010 for ASEAN6 and China and 2015 for CLMV.
  - ASEAN-Japan: End-date of 2012 for ASEAN6 and Japan, and 2017 for CLMV.
  - ASEAN-Korea: Implemented in July 2006. End-date of 2010 for ASEAN6 and Korea. No end-date indicated for CLMV.
  - ASEAN-India: Implementation date January 2007. End-date of 2011 for ASEAN5 and

India, and 2016 for Philippines and CLMV.

- There are also varying rules of origin, creating a “spaghetti bowl” effect:
  - AFTA: 40% value added, amended to include change in tariff heading and product specific as well.
  - ASEAN-China: 40% value added
  - ASEAN-Japan: depends on bilateral negotiations, some of which are still ongoing.
  - ASEAN-Korea: product specific
  - ASEAN-India: 35% value added plus change in tariff heading
- The ASEAN Plus and bilateral FTAs have not been able to resolve the sensitive issues that have bugged the WTO negotiations. Some regional and bilateral agreements may have breached the WTO GATT Article XXIV on “substantially all trade” and GATS on “substantial sectoral coverage”. Agricultural products are on the sensitive and exclusion lists of several countries, as are textiles and some other labor-intensive products and a range of service sectors.

The various ASEAN Plus agreements have improved ASEAN’s market access, improved the scope for scale economies, and improved the attraction for foreign investors. ASEAN also enjoys the political and economic benefits of a “hub”. With each agreement signed and implemented, more trade and investment and institutional and procedural barriers have come down and economic efficiency improved. The increased competition from imports and foreign suppliers and investors have also put pressure on ASEAN countries to undertake domestic structural and institutional reforms so as to improve competitiveness. At the same time, the proliferation of ASEAN Plus agreements as well as bilateral FTAs, have given rise to concerns over the “spaghetti bowl” effect and the severe demands on scarce negotiating resources, as well as to concerns that the centrifugal forces may undermine ASEAN economic integration and solidarity.

### **3b. ASEAN Plus Three and the East Asia FTA**

ASEAN Plus Three (ASEAN, China, Japan, Korea) cooperation started as an initiative for monetary and financial cooperation in the wake of the Asian financial crisis. The grouping adopted the Chiang Mai Initiative in 2000, aimed at fostering regional financial stability and resilience and building on the earlier similar agreements among ASEAN economies. The first component comprises a network of bilateral swap and repurchase facilities to assist beleaguered central banks facing liquidity crunches. The second component is a regional monitoring and surveillance of macroeconomic and financial fundamentals and policies of member economies to pre-empt another currency attack. The third component is the development of the Asian Bond Market.

There was an informal Summit of ASEAN Plus Three in December 1997, at the sidelines of the Second ASEAN Informal Summit. Since then, there has been the 2001 Report of the East Asia Vision Group (EAVG) and the 2002 Report of the East Asia Study Group (EASG). The EASG report was adopted at the ASEAN Plus Three Summit in 2002. It contains short-term, and medium and long term measures toward an East Asian community.

- Short term measures: All the recommended measures will be implemented by the 10<sup>th</sup> Anniversary of ASEAN Plus Three cooperation in 2007. Four short-term measures have already been implemented --- comprehensive human resources development program for East Asia; network of East Asia Think Tanks (NEAT); East Asia Forum; and East Asia Business Council.
- Medium and long term measures: These include a high level conference on investment and SMEs; convening of the East Asia Summit; experts group to study the feasibility of an East Asia FTA; regional financial facility; regional marine environmental cooperation; framework for energy policies and strategies and action plans.

The first East Asia Summit was convened in Kuala Lumpur on 14 December 2005. It saw the signing of the KL Declaration that established the EAS as a forum for dialogue on broad strategic,

political and economic issues of common interest to promote peace, stability and economic prosperity. Three issues arise from the EAS. First is the scope of its membership. The inaugural meeting comprises ASEAN Plus Three plus Australia, New Zealand and India, with Russia as an invited observer. However, there are rumblings that other major powers do not want to be excluded. Recent statements in June 2006 by the ASEAN Secretary General, the Indonesian Defence Minister and the Malaysian Deputy Prime Minister indicate that the EAS will not be exclusive. At the same time, there is concern that membership expansion would dilute ASEAN Plus Three confidence building and cooperation. Second is the objective of the EAS. Some observers are concerned that it will become another “talk shop”, while others hope it would become an Asian G8 type of meeting. Third is ASEAN’s concern that it remains in the driver’s seat of EAS in shaping the future of East Asia amidst superpower rivalry.

The expert group to study the feasibility of an East Asia FTA was appointed in 2005 and submitted its report to the ASEAN Plus Three governments in mid-2006.

### ***Rationale for and Challenges of EAFTA***

The 2001 EAVG Report recommended that East Asia becomes a regional community with collective efforts for peace, prosperity and progress and establish EAFTA ahead of the APEC Bogor Goals. As with the formation of any other regional grouping or bilateral FTAs, there are political and economic rationales.

- *Political objective:* A primary objective of the East Asian community and EAFTA is to reduce political and military conflicts through economic cooperation and integration. That has been the experience of ASEAN leading to a period of peace and stability in Southeast Asia. No comparable grouping currently exists in Northeast Asia. A large East Asian grouping would also increase the East Asian “voice” in international organizations and fora, in equal partnership with the Western Hemisphere and Europe.
- *Economies of scale and scope:* Modeling studies have shown that the larger EAFTA will result in more economic benefits than smaller FTAs. EAFTA, with the removal of barriers to trade and investment and freer flows of capital and labor, will facilitate the regional production networks and supply chains, and incentivize individual countries to undertake reforms and restructure their economies to better meet the challenges of globalization and regionalism in the Americas and Europe.
- *Overcoming the spaghetti bowl:* EAFTA would lead to harmonization and standardization of rules of origin, product and technical standards and conformance requirements, thus overcoming the spaghetti bowl effect from the proliferation of multi-layered and overlapping FTAs. This spaghetti bowl adds to business costs and detracts from FDI.

However, realizing the EAFTA faces a number of concerns and challenges:

- *Development gaps:* EAFTA will comprise a wide mix of economies at different levels of economic development and industrial and technological competence. Complementarities and diversities offer prospects of specialization and efficient regional production. Membership in EAFTA provide the smaller and less developed East Asian economies to be part of mainstream East Asia and enjoy the spillover effects of dynamism and growth. But it also raises concerns of marginalization of the less efficient economies and producers and suppliers. Hence governments would be reluctant to open up their farm sectors, labor-intensive industries, and SMEs which would be expected to result in adverse effects on employment, poverty incidence and income distribution, without adequate safeguards and financial and technical assistance for capacity building.
- *Common destiny:* Countries in East Asia need to be convinced that there is a common destiny and that the political and economic gains of economic cooperation and integration outweigh the costs from dilution of national sovereignty necessary for the creation of common institutions

and common rules and disciplines. Countries in northeast Asia are also still plagued by the historical baggage and mistrust.

- *External orientation:* Some East Asian countries have strong external political, security, economic and technology links with non-members, particularly with the US and EU. Hence EAFTA cannot afford to be inward-looking and must be outward-looking and inclusive. East Asian regionalism should complement and not substitute for multilateralism.
- *Membership of East Asia:* At the minimum, an East Asia FTA is pragmatically defined as ASEAN Plus Three. However, there are alternative views. Japan's Trade and Industry Minister Nikai proposed a Comprehensive Economic Partnership Arrangement in East Asia, comprising the 16 countries that participated in the East Asia Summit in December 2005 (ASEAN10, China, Japan and Korea, plus India, Australia and New Zealand). Indian Prime Minister Singh called for a pan-Asian FTA combining all the EAS members as a way forward towards an Asian Economic Community as an "arc of advantage".
- *EAFTA design:* EAFTA should be WTO-plus. In the areas of trade in goods and services, coverage should be comprehensive, conforming to GATT Article XXIV on "substantially all trade" and GATS V on "substantial sectoral coverage". Sensitive and exclusion lists should be kept to a minimum and be time-bound. Rules of origin should be intended to prevent trade diversion and not be restrictive and protective. For most rules and disciplines, it is better to conform to the international standards agreed on in the WTO. Special and differential treatment and flexibility should be accorded the least developed economies, together with financial and technical assistance for capacity building.

#### ***Possible Roadmaps to EAFTA***

The proliferation of ASEAN Plus and bilateral FTAs in East Asia opens up a number of options to reach the region-wide EAFTA.

- *Merge the Southeast Asian and a Northeast Asian agreements:* ASEAN has already an agreement among the 10 Southeast Asian countries and the economic integration programs are well advanced. But there is no parallel trilateral or bilateral agreement among China, Japan and Korea and these could be difficult to work out, particularly in the present political climate. A merger of Southeast Asia and Northeast Asia would, on the surface, be highly disadvantageous to ASEAN, since the 3 northeast economies have an economic weight of 90 percent and ASEAN only 10 percent.
- *Consolidate the various ASEAN Plus One FTAs:* Since ASEAN is already negotiating FTAs with China, Japan, South Korea (also Australia-New Zealand and India), these ASEAN Plus One agreements when realized, could serve as the basic framework for EAFTA. On the plus side, these agreements would have agreed common frameworks and liberalization schedules over large areas, reducing possible areas of dissent and dispute to a minimum. On the negative side, there is no common template in the ASEAN Plus One agreements under negotiation, resulting in a spaghetti bowl that would be difficult to unravel and forced into a convergence.
- *Deepen ASEAN Plus Three:* An EAFTA could be achieved using the existing ASEAN Plus Three framework. It was within the ASEAN Plus Three framework that EAVG and EASG recommended the formation of an EAFTA as a mid-term and long-term measure and the ASEAN Plus Three Economic Ministers in 2004 created the Joint Expert Group of Feasibility Study on EAFTA. An issue would be whether ASEAN would be negotiating the FTA as a group or as 10 separate economies. It would be difficult to arrive at a consensus, given the diversity of the 13 economies. The issue of agriculture between Southeast Asia and Northeast Asia, particularly rice, would also be difficult to resolve.

#### **4. An Alternative Approach: The P4?**

The TransPacific Strategic Economic Partnership (SEP or P4 for short) is the first trans-Pacific

plurilateral FTA involving the 4 small like-minded economies of Brunei, Chile, New Zealand and Singapore. It could incorporate the Bogor deadlines of 2010 for developed economies and 2020 for developing economies.

An initial proposal for P5, incorporating Chile, New Zealand, Singapore as well as the US and Australia failed to materialize.<sup>17</sup> The P3 (Chile, New Zealand, Singapore) was first launched in October 2002 during the APEC Leaders Meeting in Los Cabos and negotiations began almost immediately.<sup>18</sup> Brunei joined half-way through the negotiations and has been granted specific flexibilities. Chile, New Zealand and Singapore signed the agreement on 18 July 2005 and Brunei on 2 August 2005. The Agreement entered into force on 1 January 2006.

P4 has an open accession clause to encourage other APEC members to join the grouping. The criterion for accession is acceptance of the terms and conditions of the Agreement without renegotiation. It is reported in the media that APEC members that have expressed an interest in accession include Malaysia, Thailand, Mexico and Peru.

The P4 are relatively small Pacific economies, having a combined GDP of only US\$280 million. But these are among the most open economies in the Pacific. The rationales are political, strategic and economic. On the economic front, it promotes trade and investment liberalization among the 4 countries, although these economies are already very open and (except for Brunei) are engaged in a growing number of sub-regional and bilateral FTAs, so the value added could not be very much. However, it was billed as providing a “demonstration effect” to push APEC forward and hence has strategic benefits. Chile and Singapore position themselves as “strategic platforms” for foreign investors in their respective Latin American and East Asian regions. The strategic value to New Zealand and Brunei is not obvious. Given the physical spread of the P4 members, increased trade is crucially dependent on compressing distance by improving air and maritime transportation linkages.

The P4 Agreement has similar comprehensive coverage as the ASEAN Plus One agreements. It covers trade in goods, rules of origin, trade remedies, SPS measures, technical barriers to trade, trade in services, government procurement, customs procedures, intellectual property, temporary entry of persons, competition, institutional provisions and dispute settlement. What is probably unique is the “big bang” approach to trade in goods liberalization ---Singapore has achieved MFN zero tariffs; for New Zealand, all tariffs would be eliminated with immediate effect; for Chile, tariffs on 89.3% would be eliminated immediately, 9.57% within 3 years and the remaining 1.13% in 6 years. There are breakthroughs in agricultural trade liberalization, particularly as Chile and New Zealand are both southern hemisphere countries with similar climates and seasons and compete in a range of agricultural exports. Rules of origin took into consideration outward processing as an integral part of modern manufacturing processes. Customs facilitation procedures include self-certification for the claiming of preferential tariffs; risk management; and advance rulings. For services trade liberalization, P4 adopts the more liberalizing negative list approach, that is, all sectors are open except for those measures/sectors that have been expressly reserved. There is also a chapter for cooperation in 5 fields, that is, economic, education, primary industry, cultural, and science, research and technology. The Labor Cooperation MOU will enable the countries to work closely together on labor and human resource issues and provide opportunities to share views and experiences. The Environment Cooperation Agreement will enable the countries to work closely together on environment issues and provide opportunities to share views and experience.

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<sup>17</sup> It was reported that the US preferred the bilateral track with Chile and Singapore and Australia preferred the multilateral track

<sup>18</sup> Negotiating problems centered on agriculture, services and investment. In particular, Chile faced resistance from large scale agricultural landowners in the south, while New Zealand had technical and political problems finalizing its “negative list” on services.

Could the P4 be the building block to an APEC-wide FTA? P4 is a very high quality FTA, perhaps too high in view of the realities of political and economic sensitivities that characterize many less open APEC economies. The “demonstration effect” of P4 would be stronger, if some major economies such as US and Australia have been among the founding members. For countries that have the political will to liberalize their economies, joining P4 would be the right path to take.

## **5. Challenges for ASEAN and APEC**

### **5a. A Key Role for ASEAN?**

ASEAN has definitely left a footprint in regional community building in East Asia and the Asia Pacific because ASEAN has played a critical role in the development of cooperation processes in the wider region.

ASEAN’s critical role has been due to two factors. First, its experience as the “first mover” in the region influenced the modality of other regional processes in which it is involved. Second, ASEAN’s dialogue process with major countries, which established the regular (annual) Post-Ministerial Conference (PMC), provided the inspiration for a wider regional process.

When the idea of an Asia Pacific cooperation process began to take hold, ASEAN proposed that the ASEAN PMC process be the basis for it. A proposal for an Asia Pacific Forum (APF) was adopted by ASEAN Foreign Ministers but was not endorsed by some ASEAN members. The initiative was then taken by Australia, and the first Ministerial Meeting of APEC (Asia Pacific Economic Cooperation) was held in Canberra in 1989. Recognizing the fact that ASEAN had first come up with the initiative and the critical role ASEAN’s participation has in any Asia Pacific process, an agreement was made that any other APEC meeting must be held in an ASEAN country. ASEAN has since become the co-pilot in the APEC community building process.

The APEC process is characterized by the important role of the chair in shaping the agenda. The one year cycle of APEC’s chairmanship has its positive and negative aspects. However, the main problem with APEC is its loose and open-ended nature and its minimal institutionalization. APEC was ahead of ASEAN in setting a clear target for its process when in 1994 leaders endorsed the Bogor Goals of “free and open trade and investment in the region” by 2010 for developed countries and 2020 for developing countries. APEC undertook its mid-term review towards the Bogor Goals in 2005 and the widespread view is that the process will not be able to deliver on the leaders’ commitment. APEC is in the process of some soul searching now. The APEC Business Advisory Council (ABAC) proposed that APEC abandoned its voluntary nature and move towards the creation of a Free Trade Area for the Asia Pacific (FTAAP). At the APEC Summit in Chile in 2004, leaders rejected this proposal as being infeasible.

The other Asia Pacific process, the ASEAN Regional Forum (ARF), appears to have stagnated as well. Formed in the middle of the 1990s to promote cooperation in the political and security fields, in parallel to APEC’s economic cooperation process, the ARF was to become an important pillar of the Asia Pacific regional architecture. In terms of defining the process, the ARF should be less open-ended as it has formulated the three phases of confidence building, preventive diplomacy, and conflict resolution. However, the process lacks the mechanism to move from the first phase to the next, largely because it also is a very loose process. It has been questioned whether ARF’s stagnation could be overcome by ASEAN’s willingness to release its driver’s seat in the process. The ARF is by design ASEAN-driven. This resulted from a recognition that the process would not have taken off at all if it is not driven by ASEAN. The proposal for a co-chairmanship has been aired, but there has been no decision on this.

In addition to APEC and ARF, ASEAN is involved in, and in fact also the initiator of other processes: ASEM (Asia Europe Meeting), FEALAC (Forum of East Asian and Latin American Countries), and most importantly the ASEAN Plus Three (ASEAN+3) and the East Asia Summit.

There have been regular meetings of ASEM and FEALAC, but these two processes failed to produce concrete programs or measures that can confidently be seen as creating bridges to connect East Asia with Europe and Latin America, respectively.

In comparison much more is going on in the ASEAN Plus Three process. A great deal has been written lately about this process. However, the region fails to develop a strategic plan for the ASEAN Plus Three process. This is in part the failure of ASEAN, which is in the driver's seat, to do so. Instead, governments agreed on holding an East Asian Summit without having clearly visualized and articulated a strategic plan. It is really strange to have two parallel tracks involving the same countries and with no clearly distinct agenda. This resulted in an agreement, largely as an after-thought, to expand the membership of the East Asian Summit to include India, Australia, and New Zealand, the three countries with which ASEAN also has agreed to form a Free Trade Area.

The original proposal by the East Asian Vision Group (EAVG) that was endorsed by the East Asian Study Group (EASG) was to transform the ASEAN Plus Three process to an East Asian Summit process. This was to happen after a lot of preparations and a consolidation of the ASEAN-driven ASEAN Plus Three process. It was unfortunate that the East Asian Summit was prematurely placed on the region's agenda in 2005. Had a strategic plan for East Asia been properly worked out, it would have been concluded that the transformation of the ASEAN Plus Three process to an East Asian process is the most critical element for East Asian community building.

At this stage, ASEAN's main task is to consolidate its role in the region's community building processes. It must have a strategic plan to develop a new vehicle that would ensure that it as well as the Plus Three members would feel comfortable to travel in. As things stand today, ASEAN is in the driver's seat of a defective vehicle.

It is in this new vehicle that a better "roadmap" can be traveled in. But the passengers must also behave, and the driver must be fit.

China, Korea and Japan should not continue to quarrel and must come to settlement of their historical burden. Governments must, once and for all, stand up above the public and not to allow the relationship (China-Japan and Korea-Japan) be used for domestic political purposes. ASEAN too must agree on a modality that ensures the effective functioning of its international diplomacy and not to allow the organization be held hostage to one of its members, whose regime remains illegitimate.

ASEAN also needs 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 agreed 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. 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 wooed into FTAs with a number of trading partners. Two immediate issues confront ASEAN. First, would 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.

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 PTAs 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 Plus One agreements. In addition, a common framework can help reduce tensions between ASEAN members. -

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 intellectual property rights. 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.

## **5b. Challenges for APEC**

A reform process is already under way in APEC. This reform appears to have been driven by two concerns. First, that the most important agreement amongst APEC leaders thus far, namely to achieve the so-called Bogor Goals, will not be realized as scheduled. The first target date for its realization by the developed members of APEC is 2010, which is fast approaching. Second, that the APEC process has been losing steam and that APEC no longer captures the imagination of governments and peoples in the region.

If so, the objective of the reform is also two-fold. First, it is to ensure that APEC can deliver on its own pledge. Second, it is to maintain APEC's relevance and attractiveness to its stakeholders.

But what will guide the reform?

APEC's pledge to achieve free and open trade and investment in the region remains ill defined. Therefore it will not be easy to translate this commitment into a clear and operational agenda. This could be the reason why the Bogor Goals no longer create the excitement they once had. APEC will be regarded by its stakeholders as relevant and attractive if its agenda is seen as relevant and attractive.

But what will be required to successfully modify and improve the organization's agenda?

APEC needs to make changes in its agenda-setting mechanism and procedures. Setting APEC's agenda also requires sufficient appreciation of its implementation. Institutional structure and capacity will determine what agenda can or cannot be successfully implemented by APEC. The past 16 years should provide sufficient information about the weaknesses of APEC's institutional structure and capacity.

APEC's reform should be "agenda-driven". The reform is essentially about changing the mechanism and procedures to setting the organization's agenda that can be implemented. This should begin with a renewal of APEC's agenda.

APEC has developed an agenda that will assist its members in achieving the Bogor Goals. On the basis of its mid-term stock take, it has designed a roadmap for future work. Hence the Busan Roadmap to Bogor Goals. The Roadmap is meant to "fix" APEC's agenda, which now should have the following key components:

- (a) continuing work of the WTO;
- (b) more ambitious and effective CAPs and IAPs with strengthened implementation and review processes;
- (c) a more intensive focus on trade and investment facilitation and improving the business environment behind the border;
- (d) more focused and action-oriented cooperation on ECOTECH and a strategic approach to capacity building; and
- (e) a comprehensive workplan on RTAs/FTAs.

Should APEC re-open the debate on how the Bogor Goals relate to APEC's objective of building a regional community? Some have felt that the Bogor Goals are too ambitious but at the same time too narrow. They are too ambitious if "free and open trade and investment in the region" means a removal of all barriers to trade and investment by the target dates. But APEC has not defined this, and so long as this is left open, the process remains flawed.

ABAC has also made suggestions on APEC's reform. ABAC's agenda is straightforward. This group of stakeholders wants to get business done. They feel that the process of removing barriers to trade and investment is too slow. Their suggestions include:

- (a) Make the IAP review process more robust and forward-looking and IAPs more specific, transparent and accessible. Focus on what member economies have yet to do to reach the Bogor goals;
- (b) Strengthen capacity-building initiatives, especially tailoring them to each economy and building public-private partnerships to this end;
- (c) Transform the APEC Secretariat into an OECD-type Secretariat with greater resources and authority;
- (d) Enhance ABAC-APEC communication aimed at increasing private sector input, including by establishing a formal feedback mechanism of ABAC recommendations;
- (e) Increase APEC coordination on positions in WTO and multilateral fora, including in key areas of agriculture, market access and services liberalization.

ABAC feels that APEC should be able to bind commitments. It is considering whether it should or should not propose the idea of a Free Trade Area of the Asia Pacific (FTAAP), but it is likely to abandon this when it realizes that it will take a very long time to form an FTAAP.

In a recent policy brief, the Lowy Institute in Australia made the following suggestions:<sup>19</sup>

- (a) APEC should abandon any aspirations to intra-APEC trade liberalization and get back to its original purpose, namely to use its economic weight to support global multilateralism and to facilitate economic integration around the Asia Pacific region;
- (b) It should pare back much of its current over-ambitious agenda, possibly transferring some of this activity to new East Asian forums;
- (c) It should resist efforts to bureaucratize the annual leaders' meeting;
- (d) When the current membership embargo expires in 2007, APEC should declare its membership permanently closed;
- (e) The inadequate APEC Secretariat should be reorganized and provided with a more realistic funding base.

These may be some of the real issues that APEC has to confront with. The underlying interest here is "to save APEC". This is perhaps a legitimate agenda, but there must be compelling reasons for saving APEC. APEC should re-open a debate on what these compelling reasons are.

The first question to address is why the East Asian members of APEC have the strong urge to organize themselves in an East Asian regional structure, and why is it that the US has great difficulties sustaining an interest in participating actively in APEC?

The second question is whether an East Asian regional structure will compete with APEC or whether there can be a kind of division of labor between the two regional structures?

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<sup>19</sup> Malcolm Cook and Allan Gyngell, "How to save APEC?" *Policy Briefs*, Lowy Institute for International Policy, 14 October 2005.

In East Asia a strong momentum is building up to seriously explore alternative ways (“regional architectures”) that could strengthen East Asia’s position in the wider region and globally. For East Asia, APEC’s attractiveness is the promise that this forum can actively engage the United States in a community building process. Community building, to be meaningful, must have a strong strategic underpinning. Is this still present in the Asia Pacific region?

An East Asian process began in 1997 in the form of ASEAN Plus Three (APT). To some extent this was a reaction to APEC’s inability to come to the assistance of crisis-hit countries in East Asia. Why could this assistance not be mobilized in time and in a meaningful way? Is it because as an organization APEC was ill-prepared to do so, as it has no mechanisms to deal with financial crises? Or is it because the US, the largest economy in APEC, was not sufficiently focused on assisting fellow members of APEC, their partners in Asia Pacific community building? Is this because the notion of community building is too vague? Why, on the other hand, was the US capable of making maximum use of APEC to mobilize support in its fight against global terrorism following September 11?

East Asia then began with the search for its own regional mechanisms. An Asian Monetary Fund (AMF) failed to materialize; instead, it has come up with the setting up of a network of bilateral swap arrangements, known as the Chiang Mai Initiative (CMI). This CMI is a poor substitute for an AMF-type regional financing facility, but it has become an important cornerstone of community building in East Asia.

The East Asia Summit as it came into being was an accident, in terms of the timing of convening it as well as expanding its membership beyond APT to include Australia, India, and New Zealand. The agenda of EAS is likely to overlap with that of APT and also of APEC. EAS is not based on the concept of geography. Instead, it is rather fuzzy. Senior Minister Goh Chok Tong of Singapore recently suggests that an EAS should be “an architecture of variable geometry and flexible boundaries”, and as such can accommodate the US in some fashion, yet to be designed.<sup>20</sup> Many members of EAS feel that in one way or other the US must be drawn into this East Asian process. But isn’t this re-creating APEC?

If EAS succeeds to engage the US, it could well be that APEC loses its appeal to both East Asia and the US. A new regional architecture will emerge. It can have a competitive edge vis-à-vis APEC. First, its membership is smaller but includes the important Asia Pacific countries, with India as a bonus. Second, it can set an agenda that will not repeat the mistakes of APEC.

Is there hope for APEC to come up with an agenda that makes it compellingly attractive? Let us do a quick assessment of current APEC’s organs that produce the organization’s agenda.

### **Main Organs:**

- **Leaders Meeting (Summit):** This is perhaps the single most important event in the public’s eyes. How should the leaders influence APEC’s agenda? (a) Should they be the start of “top-down” processes to promoting regional cooperation by issuing “instructions” to ministers?; (b) Should they, instead, be at the end of “bottom-up” processes to promoting regional cooperation by “signing off” recommendations by ministers, advised by the SOM, that will shop around from amongst the Working Groups?; (c) Can the top-down and bottom-up processes be combined?; or (d) Should the “Leaders Track” be decoupled” altogether from APEC’s “Track

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<sup>20</sup> Goh Chok Tong, *Towards an East Asian Renaissance*. Address at the opening session of the 4<sup>th</sup> Asia-Pacific Roundtable organized by the Global Foundation, the World Bank and the Institute of Southeast Asian Studies, Singapore, 6 February 2006.

One“ to be the region’s G-8 for dialogue on strategic and critical regional and global issues. The modality that will be opted for will determine how all other APEC organs should function.

- **Ministerial Meeting:** Since the Leaders Meeting has gained prominence, the Ministerial Meeting appears to have been “out-competed” by the Summit.
- **Sectoral Ministers Meeting:** Many of these Ministerial Meetings end up being “social clubs”.
- **SOM and its Committees:** They are the real “working horses” of APEC, but they are either running without a cart or they cannot move because each horse wants to go in a different direction.
- **Working Groups:** Some may be “the living dead” in APEC. There are many important, interesting, and relevant subjects to be addressed and tackled, but the right format is yet to be found.
- **Secretariat:** If it is to function only as APEC’s “P.O.Box”, it cannot become APEC’s kitchen. Without a proper kitchen, APEC cannot open an attractive restaurant that can cater to the tastes of its potential clientele from the rather wide and diverse neighborhood.

### **Broad Agenda:**

The APEC Restaurant must have an attractive menu offering a variety of dishes, but they should not be overwhelming.

- **Liberalization:** The focus should be on regional efforts to strengthen the multilateral trading system. APEC’s own liberalization agenda should be strengthened, but “No Champion, No Go”. Unfortunately potential champions are currently more interested in “quick-yielding” bilaterals. Should the liberalization agenda be seen as the “appetizers?”
- **Facilitation:** The Lowy Institute sees this as APEC’s “hidden strength”. It may indeed be APEC’s “main course”.
- **Ecotech:** This is definitely the sweetener. It is the dessert that will complete the meal. A bad dessert will spoil the entire meal. In this sense, ECOTECH is at the heart of APEC.<sup>21</sup> Today, much of the ECOTECH projects should be put out for fire sale. This may finally be realized by APEC officials. A decision was made in 2005 to restructure the SOM Steering Committee on Economic and Technical Cooperation (ECOTECH). But this SOM Steering Committee cannot be turned into the kitchen.

How should this agenda be operationalized and be advertised to the wider public? The main course (facilitation) cannot be attractive on its own. Facilitation measures are meticulous efforts and do not capture the public’s imagination. Thus, it should be the entire meal (the Set Menu) that makes it an attractive proposition.

Implementing this will definitely require further reforms. The reforms will be guided by this agenda. This is “agenda-driven” reform at work. APEC’s mode of operation should be task-oriented. Working Groups, for instance, must have a clear sunset clause.

A Hanoi Action Plan that is concise and focused can guide this process. This can complement the Busan Roadmap, and together they can produce a more balanced agenda for APEC.<sup>22</sup>

Beyond the reform, it may well be that after all, APEC itself should be an “agenda-driven” process. For some time to come, it cannot be a process that is driven by leaders or by institutions. But

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<sup>21</sup> See Andrew Elek and Hadi Soesastro, “Ecotech at the heart of APEC: capacity-building in the Asia Pacific,” in Ippei Yamazawa (ed.), *Asia Pacific Economic Cooperation (APEC) – Challenges and tasks for the twenty-first century* (London: Routledge, 2000), pp. 218-254.

<sup>22</sup> See Neantro Saavedra-Rivano, “Options for APEC Reform”, paper presented at the International Conference ‘APEC Reforms and Evolving Trends: New Ideas for Materializing Busan Roadmap and Making Hanoi Plan’ organized by the Vietnamese Academy of Social Sciences (VASS), Ha Noi, 27-28 April 2006.

leadership is still important for the process. This underlines the notion of “issue specific” (or agenda-driven) leadership that should characterize APEC.

ASEAN should promote this “agenda driven” process for APEC. It is consistent with ASEAN’s approach. The involvement of other countries in APEC will help make sure that on the basis of this approach, APEC can have a dynamic (progressive), realistic (implementable), and an interesting (relevant) agenda.

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**Table 1: FTA Status of ASEAN Countries, as of October 2006**

<b>Country</b>	<b>Proposed</b>	<b>Framework Agreement signed/under negotiation</b>	<b>Under negotiation</b>	<b>Concluded &amp; signed</b>	<b>Under implementation</b>	<b>Total</b>
Brunei Darussalam	3	2	2	1	3	11
Cambodia	2	2	1	1	2	8
Indonesia	4	3	2	2	2	13
Lao PDR	2	2	1	1	4	10
Malaysia	5	3	5	2	3	18
Myanmar	2	3	1	1	2	9
Philippines	4	2	1	2	2	11
Singapore	5	2	8	2	11	28
Thailand	5	6	4	1	6	22
Vietnam	2	2	2	1	2	9

*Source: compiled from website: aric.adb.org*

**Table 2: ASEAN's FTA Partners**

	<b>Population 2003 (million)</b>	<b>GNP size 2003 (US\$ billion)</b>	<b>GNP per capita 2003 (US\$)</b>	<b>Exports 2003 (US\$ billion)</b>	<b>Imports 2003 US\$ billion</b>	<b>Total trade 2003 US\$ billion</b>
ASEAN-10	537.2	641	1,193	451.0	386.4	838.1
China	1,288.4	1,417	1,100	438.4	412.8	851.2
ASEAN-China	1,825.6	2,058	1,127	889.4	799.2	1,689.3
ASEAN's % share	29.4	31.1		50.7	48.3	49.6
Japan	127.2	4,390	34,510	471.9	383.0	854.9
ASEAN-Japan	664.4	5,031	7,572	922.9	769.4	1,693.0
ASEAN's % share	80.9	12.7		48.9	50.2	49.5
South Korea	47.9	576	12,020	194.3	178.8	373.1
ASEAN-Korea	585.1	1,217	2,080	645.3	565.2	1,211.2
ASEAN's % share	91.8	52.7		69.9	68.4	69.2
China-Japan- Korea	1,463.5	6,383	4,361	1,104.6	974.6	2,079.2
ASEAN+3	2,000.7	7,024	3,511	1,555.6	1,361.0	2,917.3
ASEAN's % share	26.9	9.1		29.0	28.4	28.7
Australia-NZ CER	23.9	495	20,711	86.9	107.2	194.1
ASEAN-CER	561.1	1,136	2,025	537.9	493.6	1,032.2
ASEAN's % share	95.7	56.4		83.9	78.3	81.2
India	1,064.4	568	530	54.7	69.7	124.5
ASEAN-India	1,601.6	1,209	755	505.7	456.1	962.6
ASEAN's % share	33.5	53.0		89.2	84.7	87.1
United States	291.0	10,946	37,610	724.0	1,305.6	2,029.6
ASEAN-US	828.2	11,587	13,991	1,175.0	1,692.0	2,867.7
ASEAN's % share	64.9	5.5		38.4	22.8	29.2

Source: From Chia (2005)