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ASEAN and East Asian Economic Integration

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ASEAN was formed in 1967 by the non-communist countries of Southeast Asia, primarily for political and security reasons. Early efforts at economic integration were not successful, reflecting lack of political will --- countries were still pursuing inward-looking trade strategies; trade and investment ties were largely extra-regional, mainly with Japan, North America, Western Europe; and economies lacked complementarity, producing similar primary commodities and labour intensive manufactures for export.

AFTA was established only 25 years later in 1992, in response to the political need for a "binding factor" after the Cold War, and to the economic need to compete for investments vis-a-vis NAFTA and the Single European Market. AFTA remained the only PTA in East Asia until the late 1990s.

There is currently a proliferation of plurilateral and bilateral PTAs. Most of these are FTA-plus, embodying investment liberalization, trade and investment facilitation, financial cooperation and development cooperation. Only a handful has been implemented so far, mainly with Singapore, with the majority still under negotiation or study. A sticking point in many negotiations is agriculture. The relative ease with which Singapore has concluded bilateral PTAs reflects Singapore's willingness for comprehensive coverage and the absence of the agriculture issue.

The proliferation reflects emerging political and economic forces in the 1990s. Politically, the end of the Cold War meant greater political and economic interaction among neighbouring countries. There was also the reaction to US hegemony and unilateralism, manifested in the mistrust of the "Washington consensus" by countries seriously affected by the Asian financial crisis. Further, the economic rise of China led to aspiration for a more cooperative and resilient East Asia, able to resolve regional problems on its own and having a greater say on the world stage. The crisis proved to be the trigger in another sense --- the ASEAN+3 provided the platform for political dialogue between Northeast and Southeast Asia and for monetary and financial cooperation.

Economically, the East Asian region is reacting to regionalism elsewhere, particularly the emergence of NAFTA, an expanded EU, and an emerging FTAA. In contrast to these continental economic blocs, the East Asian economies are fragmented and their exports are discriminated in these markets. This market discrimination is felt acutely by Japanese exporters struggling with over a decade of economic stagnation at home. For the developing economies in ASEAN, there is also concern over investment diversion to Mexico to serve the NAFTA market, and to central and eastern Europe to serve the EU market. Uncertainty and slowness in launching a new WTO round and the ineffectiveness of APEC in trade liberalization also led countries that wish for faster liberalization to undertake the bilateral route.

While governments negotiate PTAs to secure preferential market access, they are subject to

pressures from their private sectors. Japanese business lobby for PTAs to gain better access for their manufactures and services in overseas markets but Japanese farmers resist the opening up of the domestic agricultural sector. And while ASEAN governments are keen to liberalize to attract FDI, their domestic small and medium enterprises fear competition on their home base.

ASEAN's trade in goods is covered under AFTA, trade in services under AFAS and investment under AIA. Many are critical of the progress. Under AFTA, tariffs have been reduced to 0-5% by January 2003 for the ASEAN-6. However, the utilization rate of the tariff preferences has only been about 5% and intra-ASEAN trade remains around one quarter of total trade. ASEAN still needs to eliminate sensitive sectors and bring all tariffs down to zero for all the 10 member economies, and accelerate the removal of nontariff barriers to trade in goods and services and to investment inflows.

Two developments since 1997 contributed to ASEAN's slow progress. The first is the impact of the Asian financial crisis. Some countries delayed their AFTA commitments to protect their domestic industries. The crisis also triggered political change in a number of countries and diverted the attention of political leaders and policy makers to domestic concerns. ASEAN no longer has political leadership and sense of cohesiveness and critics increasingly point to the lack of political will in economic cooperation. The second factor is the expansion of ASEAN to include Cambodia, Laos, Myanmar and Vietnam. The expansion achieved the ASEAN political objective of uniting all of Southeast Asia. But it widened the differences in economic and political systems in ASEAN, making the subregion less cohesive and more difficult to achieve consensus building. A two-tier ASEAN emerged, with the newer members moving at a slower pace of trade and investment liberalization and needing considerable assistance in capacity building.

ASEAN's need to attract more FDI and the challenges of global competition, more particularly from China and India, are pressurizing the grouping to accelerate and deepen economic integration. At the October 2003 Summit, ASEAN leaders reaffirmed the ASEAN Vision 2020 and agreed to establish the ASEAN Community by 2020, based on 3 pillars --- political and security, economic, social and cultural. The ASEAN economic community (AEC) will be a single market and production base, with free flow of goods, services, investment and skilled labour, and freer flow of capital. Clear time lines are specified for liberalization under existing initiatives of AFTA, AFAS and AIA. Institutions are to be strengthened, particularly the dispute settlement mechanism. 11 priority sectors have been identified for accelerated integration. Reflecting that not all the 10 member states are willing and able to move at the same pace, a pragmatic "2+x" formula has been adopted, to enable any two countries to cooperate on specific sectors and other countries to join in later. Singapore and Thailand are the dynamic duo that wishes to move ahead of the rest.

An ASEAN integrated market will have a population of over 500 million but a collective GNP that is only a fraction of NAFTA or EU, less than 10% that of the Northeast Asian trio (China, Japan, South Korea) and only 1.3 times that of South Korea. Economically, ASEAN is too small to exploit economies of scale and scope and borderless production networks. ASEAN has to be outward looking and enter into cooperative relationships with Northeast Asia and other major economies.

ASEAN is being wooed into PTAs by China, Japan, South Korea, India, and US for economic as well as geopolitical reasons. There are also numerous bilateral initiatives, with Singapore and Thailand as the trail blazers. Will these regional and bilateral initiatives strengthen or dilute ASEAN? These negotiations are being conducted ahead of the realization of the ASEAN unified

internal market. A unified ASEAN negotiating position vis-a-vis external partners is difficult, as the 10 member economies are diverse in levels of economic development and economic structure, have different sensitive sectors and different capacities and willingness to liberalize. ASEAN will not be able to exploit the advantages of a hub if it negotiates bilaterally on a one-to-one basis rather than as a unified group on a ten-to-one basis. Individual ASEAN economies will become spokes and will lose substantial negotiating leverage. Multiple and overlapping FTAs also give rise to the "spaghetti bowl" effect of a complex web of rules of origin, product standards and conformance requirements. This increases business transaction costs, reduces the possibilities of economies of scale in production, and makes eventual convergence into a region-wide PTA more difficult.

The ASEAN+3 process started off with formal dialogue between Southeast and Northeast Asia for monetary and financial cooperation. It will be the foundation of an eventual East Asia PTA. There are external and internal driving forces at work. Externally, the extension of the EU in 2004, formation of the FTAA in 2005, and difficulties with the Doha Development Round negotiations will increase the desire to form an East Asian bloc. Internally, there is pressure to cooperate for mutual benefit and to leverage on the economic dynamism of China. There are many issues to be resolved. One is that of membership, as East Asia by geographical definition is not confined to the ASEAN-10, China, Japan and South Korea, but currently there are non-economic obstacles to wider membership. The second is the Japan-China relationship. A cooperative relationship between the two big East Asian powers, akin to that of France and Germany in the EU is crucial, but mistrust arising from history and emerging economic and political rivalry in the region has to be overcome. The third is convergence of existing subregional and bilateral PTAs and overcoming the spaghetti bowl effect. One possible option is that being pursued in the FTAA, as a super-layer under which the pre-existing arrangements continue to exist. The fourth is that of sequencing between the free trade area and the common currency area. Conceptually there is no reason why the sequencing should follow that of the EU, but in practice an OCA would require a greater degree of policy coordination and surrender of national sovereignty than an FTA.

Whatever the shape and schedule of the East Asia PTA, it is critical that it should not be an inward-looking bloc. First, East Asia has gained much and will continue to gain much from an open global trading system and should give full support to the WTO and the Doha Development Round. Regionalism is a complement and not a substitute for multilateralism. Second, for some time to come, East Asia will need the US security umbrella as well as the US market and technologies. In that regard, the trans-Pacific PTAs are a healthy development.