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ASEAN FREE TRADE AREA OR IMPROVED PTA?
WHAT'S IN A NAME?

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ABSTRACT

After two decades of ASEAN, there is disappointment over its lack of economic integration along the line of the European Community.

The paper reviews recent proposals for improving freer trade in ASEAN that have come from private sector groups or non-government organizations. ASEAN itself has drawn up its own scheme for promoting ASEAN trade.

The paper argues that the new ASEAN initiatives on trade and investment also attain the free trade aspects of integration. What would make it more acceptable and concrete is that it provides for more systematic interventions and allows for their phase out.

ASEAN FREE TRADE AREA OR IMPROVED PTA? WHAT'S IN A NAME?

by FLORIAN A. ALBURO*

I. Introduction

Two decades after the establishment of the Association of Southeast Asian Nations (ASEAN) an emerging consensus among "ASEAN-watchers" is that there has not been much in the way of economic integration along the line of the European Community. Whatever economic arrangements have been entered into by the ASEAN governments these have not been as substantive as one might expect in those two decades.

It is to be admitted however that what has sustained ASEAN over these years has been its continuing solidarity in many political and security issues ranging from South African matters to Vietnam and Kampuchea. In fact the group's stability in these contexts has made ASEAN a permanent institution proving an exception to a number of Third World groupings that have emerged and floundered within a short period of time.

The many criticisms on the lack of solid economic support to ASEAN, if not failure to promote economic integration, stem from two factors. One is a perception that despite the numerous economic committees, the increasing mobility of ASEAN economic officials around the capitals, and the expansion of official and independent studies on the group, there has not been an

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acceleration of intra-ASEAN trade. The other, and related to the earlier point, is the expectation of a significant economic potential of ASEAN. These do not reflect an ambitious reference to the European Community and the Common Market but a simple and practical recognition of potential economies of scale, market expansion, and industrial complementarities among the ASEAN nations.

After two decades, there is now a greater urgency to initiate bolder measures at accelerating the integration of ASEAN economies at the trading front. Perhaps even a relative shift is called for from a political and security cooperation to a strong economic interaction. Within this framework much work has been carried out to propose specific actions aimed at achieving the economic integration of ASEAN.

The purpose of this paper is to review some of the various proposals for economic integration, the subsequent reactions or responses from the ASEAN countries themselves, and their implications for the attainment of economic goals. A subtle distinction is made here between ASEAN initiatives and initiatives for ASEAN economic integration. What we want to consider as the former are those that reflect the unique cultural or official character of ASEAN economic discussions as they have evolved over time. The latter perhaps should be those that are purely economic in nature or those a step or two removed from the normal conduct of ASEAN economic affairs. In fact we argue that the emerging ASEAN initiatives will achieve similar results within the context of existing ASEAN economic environment. While

it can be argued that these may not be most-efficient (in the sense that a superior alternative is available) they appear to be acceptable operationally.

Accordingly, the next section reviews some of the more prominent proposals for ASEAN economic integration. The third section summarizes the salient points of what can be considered as the emerging ASEAN initiatives reflected in the recent meetings of ASEAN economic ministers. The last section draws out several implications from the latter initiatives.

The theoretical underpinning for a regional integration is the notion in international trade that a partial move towards freer trade improves welfare among the joining nations. The removal or reduction of tariffs among member countries should improve resource allocation and expand markets. Where they produce similar products there would be greater scope for efficiency. Thus whether the integration is only beginning (free trade area) or will move along higher forms (customs union, common market or economic union) freer trade will be beneficial.

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In the theory of second-best however we are warned that not every move towards free trade is welfare-improving in the
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sense that trade diversion may outweigh trade creation. Indeed, if the integration movement leads to trade deflection away from efficient partner source, a misallocation of resources is
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taking place.

The ASEAN countries are not homogeneous economies. Singapore and Brunei have virtually no agricultural base while the other four have a significant trade in agricultural products. Indonesia is a fairly large country with a domestic market to reap economies of scale from. On the other hand Singapore and Brunei have low tariff walls to begin with in comparison with the other four.

Differing levels and pace of development, disparities in protective structures, and size of individual countries indicate⁴ that integration benefits may not be uniform across them. Moreover not all these six countries may have similar production structures from where efficiencies can be reaped.

Economic cooperation in ASEAN has ranged from commodity reserves (the ASEAN Food Security Reserve, ASEAN Emergency Petroleum Sharing Scheme) to swap arrangements for standby credit to an ASEAN Customs Code of Conduct. In addition ASEAN has taken common positions on international economic issues such as the⁵ multilateral trade negotiations.

But, by and large, the major mechanism in ASEAN for promoting economic integration is the Preferential Trading Arrangements (PTA) whereby the ASEAN countries agreed to margins-of-preference (MOP) on intra-ASEAN imports ranging from 10 percent to 50 percent. Within the PTA, trade preferences began with voluntary offers whereby each country extends regular preferences. This was later on expanded to an across-the-board approach whereby automatic preferences were given for certain

levels of import values.

It would seem then that the institution of PTA in ASEAN is close to our notion of economic integration. In actual experience and since the PTA began in 1977, it has been plagued by a number of difficulties. First, because of the voluntary nature of the items offered for tariff preferences, products listed under PTA were those of no consequence to the ASEAN trade. There was no correspondence between the increasing number of items listed under PTA and the value of trade taking place. Second, with the use of across-the-board items for preferences, the increase in the ceiling of imports from US \$50,000 to US \$10 million opened up a stronger basis for integration. Yet its potential impact is nullified by allowing countries to put up an exclusion list for "sensitive" product imports. In fact the number of items excluded ranged from 2 percent of all items for Singapore to 63 percent of all items for Thailand. Finally, associated with the institution of the PTA is a rules-of-origin requirement which also effectively limits the scope for intra-ASEAN trade with margins of preferences.

It is in this context that new proposals for improving ASEAN economic integration have been advanced. Part of the rationale stems from the weaknesses pointed out earlier and part from a serious consideration of real new initiatives.

II. Various Proposals

We focus our attention here on specific proposals related to ASEAN economic integration in the theoretical sense summarized

previously and not on the whole gamut of economic measures regarding particular problem areas such as food reserves or standby credit. In other words, the review here is on proposals intended to promote general trade in ASEAN.

The ASEAN Economic Research Unit of the Institute of Southeast Asian Studies in Singapore Colloquium⁶ proposes a hybrid system that recognizes the inherent varying tariff structures of the ASEAN countries and differing levels of development. Thus the initiative would call for the formation of a customs union among the four countries of Indonesia, Malaysia, Philippines and Thailand and a free trade area linking the union with Singapore and Brunei. By reducing tariffs among the four toward some average (e.g. Malaysia) intra-ASEAN trade would be promoted. Since the common tariffs would mean a general reduction for the high-tariff countries (Indonesia, Philippines and Thailand) trade diversion can be reduced. On the other hand free trade arrangements with Singapore and Brunei would likewise reduce trade diversion in as much as both countries would maintain their respective tariff levels.

The Colloquium suggests complementary measures related to increasing intra-ASEAN investments including further support to ASEAN Industrial Joint Ventures (AIJV), national treatment to ASEAN investments, preferences for AIJV products, and financing facilities.

Seiji Naya's⁷ recommendations to improve ASEAN 'starts from the need to have quantifiable targets to achieve what is termed an "ASEAN Trade Area" by the year 2000. This essentially

means some 90 percent of total ASEAN trade under preferences, reduction in the exclusion list to 20 percent of import volume, and differential elements for Singapore and Indonesia. The latter mechanism reflects a practised principle of "6-x" which has been applied to rules of origin as regards Indonesia and an earlier move by Singapore not to participate in the ASEAN

Industrial Complementation Schemes.⁸

Complementing the trade area measures, Naya suggests more cooperation in industrial joint ventures and the establishment of a Development Bank of ASEAN.

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The Group of Fourteen, of the ASEAN Chambers of Commerce and Industry urges an "ASEAN Market Liberation Initiative" which proposes putting a 50 percent minimum margin of preference (MOP) and applying it across-the-board for all non-agricultural products on a six-minus-x principle. This means the elimination of exclusion lists and allowing only waivers in emergency cases where injury is certain in some specific sectors of a country. For agriculture the Group suggests continuing a product-by-product approach to liberalization.¹⁰

The supporting measures include strengthening the AIJV (e.g. MOP on ASEAN sourced intermediate inputs, national treatment), streamlined institutional machineries through consolidation of existing committees and the creation of new ones, and improving the infrastructure for ASEAN trade in such areas as transport, monetary and financial machineries, education, etc.

These non-government (or only indirectly government sponsored) proposals have a clear connotation of leaving the private sectors to adjust to new conditions after the policies have been put in place. They do not envision an elaborate bureaucracy to oversee the arrival of an ASEAN trade area. Although they do not contain detailed steps in the process they suggest a large amount of automaticity. For instance the Group of Fourteen suggests an across-the-board MOP to all (industrial) products which means an immediate act despite allowing for exceptions. The same can be said of the Colloquium proposal wherein the four countries aim for a union-external-tariff target along Malaysia's levels and an immediate free trade area. But even if we allow for a transitory phased implementation what is implied are pre-determined rules and then leaving the private sectors in the ASEAN countries to adjust accordingly.

On the other hand, the governments of ASEAN have mobilized existing structures and committees as issues groups also in order to come up with new initiatives for economic cooperation or integration. In the case of trade expansion, the Committee on Trade and Tourism (COTT) has its own package of proposals which partly is supportive of the Naya proposals. The Committee on Industry, Minerals and Energy (COIME) has looked at measures to increase investments through more or better incentives such as allowing non-ASEAN investments in AIJV within a time frame, extending the period of effectivity of preferences in AIJV as well as their levels and so on. Other Committees and

Subcommittee have similarly come up with initiatives in agriculture, tourism, transport and communications, and banking and finance. Moreover the machineries of ASEAN have come under close review in order to arrive at proposals for alternative mechanisms for ASEAN cooperation.

In summary, the various proposals that have been put forward and briefly reviewed here depict alternative scenarios of ASEAN economic integration and cooperation. They range from measures for more autonomous free trade to specific targetting exercises via existing or strengthened mechanisms. In all these the implied goal is economic integration in the sense of aiming for wider markets, industrial efficiency and thus regional welfare.

The scenarios the various proposals foresee come with appreciation of certain existing culture or characteristic within ASEAN. But by and large they have been put forth, whether independently pursued, commissioned or government-initiated, in anticipation of renewed commitment to the economic integration of the region.

III. An ASEAN Alternative

Between the 18th ASEAN Economic Ministers Meeting (AEM) in 1986 (Manila) and the 19th AEM in 1987 (Singapore), profound changes have taken place in the framework of ASEAN economic cooperation and integration. For one, this year's work has had less rhetoric than the broad pronouncements of ASEAN's economic goals made last year. For another several concrete documents,

papers and monographs have evolved since then focusing on initiatives for regional cooperation. Finally, individual ASEAN governments and Committees have buckled down to work on proposals for the ASEAN Summit along broad fronts including economics.

The distinction of ASEAN alternative proposals, mulled in part by the region's economic officials, is that it captures what is feasible and within the culture and practice of the regional circuit. For sure, ASEAN has had to seek external views in order to formulate its own versions. In a sense, such initiatives would then be uniquely ASEAN.

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From a number of indicators, ASEAN's thrust does not seem to be in the abstract notion of integration or trade preferences i.e. where general trade barriers are removed and market forces are allowed to determine net trade effects. Rather the ASEAN alternative begins with and is anchored on the PTA. The thrust then is strengthening this system from where integration or free trade area will be realized.

Several features of this ASEAN alternative clearly manifests a concrete direction. First there is an objective of increasing the share (volume and value) of trade covered by PTA at the "turn of the century." This objective, while not cast in quantitative terms, reflects a schedule and a timetable and when viewed in the context of the other features is equally contemplative as a pronouncement for the year 2000.

Second, efforts will be made in the next 5 years to reduce the size of the exclusion list to 10 percent of traded items

(using a standard trade classification scheme and aggregation) and 50 percent of intra-ASEAN trade value. At the same time the countries will harmonize their exclusion lists.

Third, MOP's are expected to be deepened from its present 25 percent as minimum MOP to 50 percent for those enjoying some tariff reduction under the existing PTA. We expect ASEAN to determine and come to an agreement on the manner of phasing in items for PTA.

Fourth, there is a realization on the need to allow some countries a differential treatment in the enhancement of the PTA.

Finally, there is a commitment in ASEAN to a standstill in the imposition of further trade barriers and their rollback in terms of non-tariff barriers.

There are other features of these ASEAN trade enhancing measures such as content requirements and rules of origin. The point is that this alternative is more circumscribed than how the PTA was practised before. Moreover, it is attuned to existing mechanisms.

Aside from the trade aspect of ASEAN industrial development through regional efficiency is also an ASEAN response to investment initiatives. Here it seems that the region views the ASEAN Industrial Joint Ventures (AIJV) as effective conduits for soliciting private sector participation.

There is an emerging acceptance of a 90 percent MOP for AIJV products among participating countries, greater automaticity

in the approval process for joint ventures with a list put out by individual countries, national treatment in the location of AIJV plants, local content accreditation, tariff binding, and provision of non-ASEAN equity participation within a prescribed time period. In addition efforts will continue towards some coordination of industrial plans in each ASEAN country.

This ASEAN alternative we have outlined has been borne out of considering various proposals. Trade and investment constitute a two-pronged approach at economic integration and an aim towards a free trade area emphasizing the feedback between expanded trade and induced investments to reap the economies of wider markets.

Apart from trade and investment, ASEAN has also proposed other initiatives in agriculture and food, tourism, and transport and communications, among others. These are meant to support or create an environment for an enhanced trading and investment systems in ASEAN. Then there are a variety of alternative institutional arrangements which can increase the effective channels for economic cooperation.

What seems to underlie this ASEAN alternative is not so much a search for new directions for the ASEAN economies out more of renewing a faith that as long as our trade policies are consistent and have a common theme across countries, private sector motivation, comparative advantage, and efficient infrastructure will move us towards economic integration.

IV. Implications

In the final analysis, our evaluation of the various proposals and the ASEAN alternative hinge on answers to many questions. Can (and will) the benefits of economic integration viz. improved resource allocation, market expansion, and efficiency, be achieved? Are initiatives around the PTA instead of, say, customs union cum free trade, the better way to integration? Are the proposals realistic and achievable under the ASEAN culture of the past two decades?

There are two overriding factors that shape the attractiveness of an ASEAN alternative. First, there is a continuing general trend towards global liberalization. This seems to be the case for the high-tariff countries in ASEAN like Indonesia, Philippines and Thailand. Global liberalization would tend to reduce trade diversion despite an ongoing regional grouping. Second, there is a tendency in ASEAN to avoid abstract or politically sensitive conditions. In the last AEM references to "free trade" area or "customs union" were avoided, although¹⁴ they apparently are the alluded direction.

A seriously pursued and strengthened PTA with its associated features as described earlier will definitely expand the scope of intra-ASEAN trade. A harmonized and limited exclusion list to the PTA guarantees that exemptions would not be fragmented even though their identification and determination are subject to negotiations. An agreed-upon depth in MOP will

certainly induce efficiencies in import substitution.

The fact that such PTA improvement is proposed to have a 5-year schedule will allow incremental phasing-in to be rational. The review process will allow adjustments to the details of the PTA. And because the implementation of PTA is spread over time it can allow for differential speeds for certain countries as may be agreed upon by ASEAN.

In short, increasing MOPs exercised through PTAs are close substitutes to a purely free trade area, even closer the greater the share of intra-ASEAN trade through it (which is envisioned in the ASEAN proposal). This is different from a collective declaration of all six countries as a free trade area or eventually a union. A standstill and rollback of non-tariff barriers (NTB) is a commitment not to put discretion in the way of increased trade. Indeed a free trade area will have less meaning without reducing NTBs as well. Thus the ASEAN proposal in the previous section takes into account NTBs.

On the other hand the proposals for investments complement trade initiatives. The automaticity of listings for AIJV products gives greater confidence to potential investors. A 90 percent MOP, which is close to free trade, improves market access and efficiency. Various dimensions of national treatment are likely to increase investment prospects since this includes local content accreditation for inputs of ASEAN origin and access to retribution for unfair trade practices such as dumping.

In short, the investment initiatives are likely to lead to

freer movement of capital. Coupled with significant MOPs for the products among the participating countries, flows will not only be enhanced within ASEAN but also from outside the region.

It is therefore apparent that given this set of PTA-related measures it is possible to achieve economic integration and move towards a free trade area. But what makes this more acceptable and uniquely ASEAN other than having been mulled over by the AEM and the region's officialdom?

Because of the more systematic nature of the measures, signals to the private sector will obviously be clearer and provide it with the amount of certainty for stable

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planning. Similarly a specified schedule and timetable also give the various governments parameters for the design of domestic policies and programs in support of ASEAN.

Perhaps what this proposal preserves is much of the ASEAN bureaucracy that has grown over the years. In fact the proposal can give both more meaning and direction to it. In particular the various arena for negotiations will become more focussed. For example, instead of coming up with only separate exclusion lists substantive work can be done in harmonizing such lists across countries.

A bureaucracy is required to help put individual countries at par with each other. In the case of the Philippines which has more items under PTA a task required is to arrive at a common

number of items. Similarly bureaucrats have to determine common and standard commodity classifications especially since ASEAN preferences require a good tariff base.

In-country exercises will be spent on arriving at specific targets such as the number of items for exclusion (which is not to exceed 10 percent) and for negotiation for harmonization. Prioritization of products for deeper MOPs will become a substantive piece of work for country bureaucrats. Of course it may be that "committees beget subcommittees which beget working

groups"¹⁶ but the tasks will have been clear and may lead to a streamlined bureaucracy. Put differently, the "travelling

circus"¹⁷ may remain but it shall have been more specialized with specified work programs that are consistently followed through over time.

Then there is a review process at the end of the first 5 years of implementation. Again this provides a juncture within which the ASEAN machinery is put to work and the AEMs meeting is to set corrective measures mid-way.

In summary the pursuit of ASEAN proposals requires a certain amount of intervention within the frame of reference of much of the existing regional capacities if not machineries. While it is true that other alternatives such as the Colloquium's proposal also require intervention in the transition, the ASEAN alternative seems to require the least disruption.

There is also the element of delays in getting the economic cooperation or integration going given the required

bureaucratic movements. This is an accepted criticism but maybe the incremental "benefit" may this time outweigh the inherent "costs", in terms of a circumscribed task. Besides this is what makes such a proposal acceptable and indeed ASEAN.

The proposed measures set out at the AEM are to be placed before the Heads of States for consideration. But with the emphasis on economic cooperation (since integration is associated more with independent market forces dominating) and minus very specific dates and the free-trade-and-related jargon they may be viewed positively and pave the way for a real economic backbone to ASEAN.

One can of course argue that all these are not really essential in a situation where trade adjustments are left to individual economic agents. Indeed a bureaucratic layer only invites inefficiency. But the point is that the proposed ASEAN alternative puts order into the bureaucracy, determines a systematic procedure for promoting trade, and paves the way for its exit or phase-out as a trade area comes closer in fruition. Maintaining a more meaningful PTA system also achieves the character of an ASEAN free trade area.

From a purely economic viewpoint, this scheme provides a feasible program for regional integration except that it is guided by a more visible hand.

FOOTNOTES

¹ See R.G. Lipsey, "The Theory of Customs Union: A General Survey," Economic Journal (September 1960). Later articles came out especially on its relevance to developing countries but Lipsey's survey catches the second-best elements of the theory.

² J. Viner, The Customs Union Issue (New York Carnegie Endowment, 1950).

³ Indeed the general trade thesis is that global liberalization and multilateralism are first-best.

⁴ If some countries have high tariff levels to begin with, their benefits from tariff reduction will not be proportionate with some other countries which have low tariffs, upon their formation of a trade area or union.

⁵ Chng Meng Kng, "ASEAN Economic Cooperation: The Current Status," in Lim Joo-Jock (editor) Southeast Asian Affairs 1985 (Singapore: Institute of Southeast Asian Studies, 1985).

⁶ ASEAN The Tasks Ahead (Singapore: Institute of Southeast Asian Studies, 1987).

⁷ "Toward the Establishment of an ASEAN Trade Area," A report prepared for the ASEAN Secretariat and the Committee on Trade and Tourism (Honolulu: East-West Center, March 1987).

⁸ Chng Meng Kng, OP. CIT., p. 42.

⁹ ASEAN: The Way Forward, The Report of the Group of Fourteen on ASEAN Economic Cooperation and Integration (Kuala Lumpur, Malaysia: Institute of Strategic and International Studies, 1987).

¹⁰ The Group of Fourteen (G-14) seems to judge that since agriculture accounts for a large portion of ASEAN countries' employment, this sector is more sensitive to broad reforms than industry. Yet what has bogged down the past PTA performance has in fact been in industrial products.

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See for example The Singapore Straits Times (July 8, 9, 10, 1987).

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It is essential that the ASEAN countries come to an agreement as to what trade classification and level of aggregation is to be used in drawing up lists.

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AIJV can takeoff even with only 2 participating countries and not all 6.

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See the Singapore Sunday Times (July 12, 1987).

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There is an inherent question whether in fact the private sector in ASEAN would not put up a resistance to the initiatives despite the bold proposals of the G-14.

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Chng Meng Kng. op. cit., p. 49.

17

Ibid.