

Singapore Bilateral FTA and AFTA

by

Dr. Mohd Haflah Piei

Malaysian Institute of Economic Research

When Singapore and New Zealand signed a memorandum of understanding in September 1999 to launch negotiation on the bilateral free trade agreement between the two economies, the other ASEAN member countries were taken by surprise. The latter were not adequately consulted by Singapore as to the objectives and modalities of the proposed pact and how it would fit in within the AFTA process. This does not keep up with the ASEAN spirit of goodwill and mutual respect. Understandably, it has caused serious concerns and anxieties among other members of ASEAN, particularly Malaysia.

Singapore, on her part, may have her own rationale for not notifying the rest of the ASEAN countries. Notification and consultation may run the risk for the initiatives being subjected to rigorous and thorough examination by other ASEAN members, which may jeopardise the negotiation process.

Things are becoming more sensitive and complex when Singapore, instead of making effort to alleviate her neighbours' concerns, started to launch another series of negotiation for similar bilateral pacts, with non-ASEAN countries. First, it was with Japan, followed by Mexico, the US and Australia. More countries have been approached which include among others Chile, Canada and EFTA member countries. Soon, there will be a proliferation of this "hub-and-spoke" type of arrangements with Singapore serving as the hub while other members of the pacts act as the nodules. This pattern of trading arrangement contravenes WTO rules and principles and poses a threat to the multilateral trading system.

There are a number of strong possible reasons that prompted Singapore's move to expedite the negotiation for bilateral free trade agreement with non-ASEAN economies.

First, Singapore might have observed that AFTA has not been progressing as fast as she had expected. She might have even detected clear signs of backsliding on AFTA commitments by some members of ASEAN. Malaysia's deferment of its commitment to fully liberalise its automotive industry is a case in point.

Second, ASEAN decision to water down the Angkor Agenda, a report of a high level ASEAN task force which strongly recommends the formation of a free trade area linking ASEAN and the CER countries (Australia and New Zealand) might be another triggering factor. This is because Singapore has been very up beat on the prospect of this inter-regional linkage as it has just concluded negotiation for bilateral pact with New Zealand.

Third, given the pace at which AFTA is moving and coupled with some bitter lessons that Singapore had learned from the recent regional crisis, she might be planning to reduce her dependence on the regional economies by forging closer economic integration with her major trading partners outside the region. This would, in the long run, ensure economic resilience and security for the city state. Seen in this context, Singapore's bilateral pact with Japan would provide a launching pad for her to penetrate the wider East Asian economies, considering that Japan too is planning to form bilateral trading arrangement with Korea and China. Similarly, her approach to EFTA countries is done with the prospect of the larger but highly protective European market in mind, while the Chilean initiative is to link it with the wider Latin American market.

ASEAN anxieties over Singapore bilateral pacts with non-ASEAN countries include the primary concern that the pacts would result in massive trade deflection into the regional market. The latter refers to import penetration of the ASEAN market by non-ASEAN countries through Singapore, which has the lowest tariff, and for

subsequent re-exports to the rest of the ASEAN countries by utilising the AFTA Common Effective Preferential Tariff (CEPT). Put simply, it means ‘back door’ entry of non-ASEAN product into the ASEAN market through Singapore.

In doing so Singapore would be doubly-rewarded. Beside enjoying cheaper imports from non-ASEAN sources, it may also expand its export markets within ASEAN under the AFTA arrangement. All these would be taking place at the expense of the products of the rest of the ASEAN.

Things could get worse, if products of other ASEAN countries would be rendered less competitive vis-à-vis those of Singapore in the market where Singapore has bilateral trading arrangements such as New Zealand, Japan and the US. In the latter markets, Singapore’s products would be imported duty-free or at a more favorable import duties than those imposed on the products of other ASEAN countries.

In the area of direct foreign investment , the worry is that Singapore’s bilateral free trade agreement with non-ASEAN economies would result in the diversion of investment from other ASEAN countries to Singapore. This is to take advantage of Singapore’s expanded market in countries which it has bilateral pacts. This will not augur well with the rest of ASEAN member countries given the current lacklustre investment climate in the region.

Beside the above concerns of ASEAN with regards to the Singapore initiatives, we can expect more issues to emerge as negotiation on the bilateral pacts progresses. Singapore’s positions in such issues as human and labour right, environment, intellectual property right, investment principles and e-commerce, to name a few, would be closely watched by fellow ASEAN members and can become a major cause for concern, if it works against those of ASEAN’s common interests and stance. Thus, to what extent that these concerns are real and if they are, how could ASEAN addresses them?

First, the issue on trade deflection as a result of the bilateral trade pacts. It is actually a non-issue as long as those non-ASEAN products have undergone substantial

transformation or processing in Singapore such that their Singapore or cumulative regional content are at least 40 per cent of their f.o.b. prices as stipulated under the AFTA agreement. Anyhow, trade deflection may also take place through Brunei Darussalam whose average tariff rates are as low as those of Singapore's. Hence, the bilateral trade initiatives could not be discredited solely on the basis of their potential trade deflecting effects. If there is an increase in trade deflection at all as a result of the bilateral free trade agreement, it has a lot more to do with the design and enforcement of AFTA's rules of origin requirement.

At present, the AFTA's rules of origin require that for a product to be deemed as ASEAN and hence be eligible to enjoy the preferential CEPT treatment, it should have at least 40 per cent national or cumulative regional content. And this requirement applies to all products in order to keep the ruling simple, and easier to comply with, especially among the new members of ASEAN.

To improve on the design, perhaps, ASEAN may vary the percentage based on the sensitivity of the products or the origin of the products within ASEAN. For example, sensitive products where the scope for trade deflection is expected to be significant, ASEAN may set higher domestic or regional content requirements. Alternatively, ASEAN may opt to adopt higher domestic or regional content for the more developed ASEAN countries than those for the newer ASEAN members. This will make it difficult for imports from non-ASEAN members to be deflected through Singapore.

Both approaches have been applied in the case of NAFTA where certain sensitive products like automotive, textiles and clothings and some specific agricultural products, imported from Mexico, are subjected to higher domestic content ruling. As an example, there is the requirement of almost 100 per cent sourcing of inputs from North America if Mexico is to benefit from tariff-free access to the North American market in most clothing exports from Mexico. Another example may be found in the local content requirement of 62.5 per cent for automobiles.

However, in redesigning the rules of origin extreme care needs to be observed so that the changes would not lead to trade diversion or trade restriction which would erode the net benefit of the AFTA in the first place.

Will ASEAN products become less competitive vis-à-vis Singapore's products in markets where the latter has bilateral pacts, say, the US? It is still too early to see whether Singaporean products will become more competitive vis-à-vis ASEAN products in the American market. It will depend on the final text of the agreement particularly with regards to its rules of origin clause.

The US certainly would not allow imports from Singapore to enter its market freely without ensuring that the products are genuinely of Singapore's origin or else it would result in a massive 'back door' penetration of the US market by ASEAN products through Singapore. The scope for this to take place is significant since traditionally, a large proportion of Singapore's exports comprises of re-exports of Malaysian and Indonesian products to third countries. Hence, the US would be more wary of this trade deflection to occur. One may therefore expect the US to impose stricter domestic content requirement on imports from Singapore, especially on specific sensitive products which compete with its own domestic products. This will deprive Singapore's option to source its inputs from the cheapest sources. This would result in higher cost of production and price of Singapore's products than before the bilateral pact. Therefore, it is premature to say that ASEAN products would be rendered less competitive as the result of the bilateral trade pacts.

On investment diversion, a more worrying trend is for investment to be diverted away from the region rather than to Singapore as the result of the trade pact. The latter is preferable to the former, as investment will still be retained within ASEAN and this will comply with the ASEAN Investment Area (AIA) programme. Furthermore, there is a limit in Singapore's capacity to absorb some types of FDI activities and once this limit is reached, it will spillover to its neighbouring ASEAN countries.

Notwithstanding the likely impact of Singapore's bilateral FTA, it would be in the best interest of ASEAN, individually as well as collectively, to take pre-emptive measures to mitigate the negative impacts of the bilateral trade pacts, if any.

One such measure is the current initiative to form bilateral pacts between ASEAN as a bloc, with Japan, China and South Korea individually. This may mitigate any diverse impact of the Singapore's initiatives and open up windows of opportunities for ASEAN. Needless to say, they have to be negotiated meticulously in terms of the areas to be covered, the time frame and modalities etc., with the view to complement the AFTA process.

A better proposition is for ASEAN to revive the East Asian Economic Caucus concept, as the three East Asian economies have shown an unprecedented move to willingly embrace regionalism. This was evident in their recent endorsement of the "ASEAN Plus Three" initiatives.

ASEAN must seize this rare opportunity rather than crying over Singapore's seemingly 'unASEAN' moves.