

Beware of proliferation of regional/bilateral trade initiatives

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by

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The outbreak of the deadly Severe Acute Respiratory Syndrome (SARS) epidemic serves one useful lesson to the East Asian and ASEAN (Association of South East Asian Nations) communities that the countries in the region are highly interdependent, economically as well as socially. The fact that the deadly virus has spread so fast throughout the region goes to show that the region's boundaries have become more porous than we had thought, as people in the region move freely across national borders for trade, business and tourism. No country in the region is spared of the contagion effect of the virus, not very different from the case of the financial crisis which struck the region a few years ago. By the same token, no country can overcome this problem single-handedly. It inevitably warrants intensified cooperation more than before among all the East Asian authorities and communities.

By sheer coincidence, the current need for enhanced regional cooperation takes place at a time when some ASEAN countries appear to turn their back on regional economic cooperation by over-zealously promoting bilateralism in their trade policies. As a consequence, there are already several bilateral free trade agreements (BFTAs) being formalised between individual ASEAN countries with individual non-ASEAN countries. More BFTAs are in the various stages of formation.

Even in the currently negotiated ASEAN-China FTA, which is supposed to be a trading arrangement between ASEAN as a region with China, bilateralism features strongly in trading arrangements between China and individual ASEAN countries. In other words, bilateralism coexists as an important component of the regional arrangement between ASEAN and China.

The proponents of BFTAs have put forth several arguments. In the context of ASEAN, a BFTA between an ASEAN country and a non-ASEAN country may

trigger similar initiatives by other individual ASEAN countries with non-ASEAN countries.

To be more explicit, when Singapore signed a BFTA with Japan, other ASEAN countries started negotiations to create their own FTA arrangements with Japan. In the end, Malaysia, which was previously critical of the arrangement, finally decided to negotiate one with Japan so as not to be disadvantaged and discriminated against in the Japanese market.

If similar trade arrangements are to be developed between ASEAN and its major trading dialogue partners, it is claimed, there will be free trade not only within ASEAN, but also between ASEAN and its dialogue partners. It will not only complement the AFTA implementation, but also extend ASEAN's outreach to the rest of the world.

Furthermore, it is argued, if more countries are offering to form FTAs with ASEAN, regionally or bilaterally, ASEAN may develop a hub position for itself with respect to its major trading partners particularly the East Asian countries of China, Japan and Korea. This may be a very strategic and potentially powerful position for ASEAN to capitalise on. ASEAN might even be able to go further by consolidating and leading all the regional arrangements in East Asia into one East Asia Free Trade Arrangement as a response to the powerful regional economic blocks in America and Europe.

However, there are as many risks as there are benefits in the above trade policy approach for ASEAN i.e. the promotion of FTAs between ASEAN as a region and its individual dialogue partners side-by-side with the increasing number of bilateral FTAs between individual ASEAN members and its dialogue partners.

Firstly, given the diversity of ASEAN countries and their individual sensitivities, any bilateral FTA signed would actually differ from one another in terms of its coverage, rules and regulation, depth of tariff reduction, etc. They may not also be consistent with the FTA negotiated between ASEAN as region and any its dialogue partners. e.g. the ASEAN-China FTA. This will not only create serious

problems for ASEAN in managing its external trade relationship, but also add to the cost of doing business, as investors and traders will have to deal with differences in scope and speed of tariff reduction and rules and regulations. To date, several BFTAs are being formed in ASEAN, but there has been no serious effort to monitor and coordinate these bilateral FTAs to ensure that they are consistent with other regionally negotiated FTAs between ASEAN and its dialogue partners. In other words, there is no common framework agreement to coordinate or provide consistent guidelines for all the FTA initiatives.

This will create problems for a reconciliation of the bilateral FTAs with the common framework agreement, if there is to be one. It will involve a very costly adjustment process, balancing sometimes irreconcilable outcomes in ASEAN.

The coexistence of regional and bilateral FTAs may be viewed as a sign of ASEAN's disintegration. The situation may be exploited by ASEAN's trading partners to their advantage in their negotiations for bilateral and regional FTAs with ASEAN. There is already evidence of this outcome in the presently negotiated framework agreement between ASEAN and China where progress thus far appears to be driven and dictated by China.

Right from the outset, President Bush's Enterprise for ASEAN Initiative has ruled out any bilateral FTAs with Cambodia, Laos and Vietnam for not being members of the WTO. Specific items in the Singapore-US bilateral FTA are consciously being crafted to irritate and discriminate Malaysia. Certain products produced in Batam and Bintan would be covered under the bilateral FTA while products produced in Johore by Singapore companies will not be given the preferential treatment. The issue is why Batam and Bintan but not Johore? After all, the sub-regions are in the SIJORI (Singapore-Johore-Riau) triangle.

Finally, on the contention for ASEAN to take the hub position in its relation with its trading partners, the key question that needs to be asked is whether ASEAN is truly and substantively a "hub" for East Asia, or merely symbolic.

On closer scrutiny, it would appear that ASEAN still lacks the economic criteria to be labelled a hub because it has yet to possess the attributes considered necessary to be a hub. Economically, it has yet to establish a truly integrated and enlarged regional market. Merely having FTA arrangements with most of its dialogue partners will not make it a hub and the economic outcome may fall short of expectations.

One of the limiting factors is the fact that ASEAN's market share for most products involved in each of the FTAs is relatively small compared to its partners. For instance, ASEAN market share for most products covered under the ASEAN-China FTA is still small and fragmented compared to China's. Given these circumstances, it would not make sense for Chinese investors to locate their investment in ASEAN as a result of the FTA (home market benefit effect). Even though the FTA would reduce the unit trade cost between the two partners, Chinese as well as ASEAN investors may still prefer to locate their plants in China. Even for products where the cost of production is higher in China compared to ASEAN, investors would still prefer to locate their plants in China since the high unit production cost in China would be more than offset by the better market access that a large country like China would present. In short, from an economic point of view, China appears to have a stronger claim to be the hub than ASEAN.

One may argue that this trend may be reversed once ASEAN-Japan CEP (Comprehensive Economic Partnership) and ASEAN-US FTA are in place, given that ASEAN would have a significantly expanded market. This may not necessarily take place. Once a particular location gets a head start, in this case China, it will be extremely difficult to arrest the tide, let alone reverse it. In other words, the policy, even when it is intended to be transitory, may in reality induce prolonged or perennial harmful consequences.

ASEAN may face a similar outcome with respect to the other FTAs that it is pursuing with Japan, the United States, and CER (Australia-New Zealand Closer Economic Relations), if it is not careful in strategizing and crafting those FTAs. Instead of being the "hub" of East Asian FTAs, ASEAN may just end up being another "spoke" of regional and bilateral FTAs.

Given the above, it is imperative that ASEAN be proactive and assert itself in crafting the FTAs in order that they are at least consistent, built upon each other,

in such a way as to serve as building blocks for the multilateral system. This calls for the adoption of a Common Framework Agreement to be the basis for future FTA-related negotiations, especially in the light of the growing number of agreements that ASEAN is likely to be involved in the next few years. For this, a series of issues and questions needs to be addressed, options outlined and responses prepared. The scope includes the nature and coverage of the agreement, the implementation mechanism, and sequencing and timing of the agreement, among others.

First and foremost, ASEAN needs to identify and adopt the ultimate form of its relationship with its prospective partners. Is it aiming to form an FTA, comprehensive economic partnership or closer economic cooperation? If the answer is an FTA, what would be the minimum coverage of goods and sector, its implementation mechanism (reduction or elimination of tariffs only, or to include non-tariff measures as well), approaches to tariff reduction and the rule of origin (minimum level of regional content)? How should the exclusion list be dealt with to allow flexibility, whilst at the same time ensuring comprehensive coverage of the FTA?

The trend now is for a more comprehensive agreement that goes beyond the removal of tariff and non-tariff trade barriers to include trade facilitation measures such as conformity of standards and procedures, trade in services, and general cooperation elements (human resource, technology cooperation, e-commerce, etc). A comprehensive agreement is preferable since it can accommodate the interests of a greater number of participating members.

Another important factor to consider is how to introduce elements which would make it a model which in turn would ensure that the process of preferential "opening up" translates into a building block of the multilateral trading system.

Finally, ASEAN needs to set the timeframe and appropriate sequencing for negotiating as well as implementing the FTA. Protracted negotiations should be avoided, given the limited time and resources of the ASEAN economies. Perhaps, the process of negotiation can begin with co-operation and facilitation programmes involving elements that are easier to agree on. Almost simultaneously, negotiations involving the trade liberalisation aspect of the FTA may start with the prospect of an "early harvest".

This may help avoid skepticism in the FTA process, as negotiations are likely to be difficult and protracted—at times, with the lowest common denominator prevailing and the results being less than satisfactory. In short, apart from reducing risks, ASEAN can bring the separate arrangements (with China, Japan, CER, Korea, U.S., India) under a CEP framework. This will greatly reduce the problems and difficulties that ASEAN faces in managing its future economic co-operation with its dialogue partners, as well as other external parties, in the future.

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