THE NEW WAVE OF FTAs IN ASIA: WITH PARTICULAR REFERENCE TO ASEAN, CHINA AND INDIA

by

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1. Introduction[1]

Virtually all developing countries in Asia have committed themselves to increased trade openness unilaterally, though the timing, pace and modalities at which they actually integrate with the global trading system have varied. Nonetheless, recognizing that they have limited influence in the multilateral arena where recent progress (Seattle and Doha rounds) on trade and investment liberalization is perceived to have been disappointingly slow and negotiations protracted and cumbersome, many Asian economies have underscored the need to consciously and aggressively explore alternative liberalization paths or “fallback positions”. This is where the “new regionalism” comes into relevance. Free Trade Agreements (FTAs) appear to be increasingly regarded by Asian policymakers as effective and expeditious instruments for achieving trade liberalization among “like minded” trading partners[2]. The Asian Development Bank (ADB) recently noted:

> The operational question now facing policymakers is how to achieve fuller benefits of increased openness to trade .. FTAs.. are, at the moment, a popular means of liberalization in the face of domestic and international constraints. There has been a substantial increase in the formation of regional FTAs in the past decade (ADB, 2002, p.161).

The new wave of FTAs has three important features. One, they go well beyond just merchandise trade liberalization and also encompass liberalization of services trade and other trade facilitation measures which lead to “deep integration” among partners. These measures include investment protection and liberalization, harmonization and

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[1] Sections 1 and 2 draw partly on earlier papers by the author, viz. Rajan (2003a), Rajan and Sen (2003 and 2004) and Rajan et al. (2001).

[2] The term “preferential trade agreements” or PTAs would be more apt in view of the non-multilateral nature of such agreements.

mutual recognition of standards and certification, protection of intellectual property rights (IPRs), opening of government procurement markets, streamlining and harmonization of customs procedures, and development of dispute settlement procedures[3]. Two, FTAs are not restricted to just the immediate regions (e.g. Singapore-US, Thailand-Bahrain); thus the term "regionalism" is somewhat of a misnomer. Three, because of the depth of issue coverage, the new FTAs tend to be far smaller in initial membership (i.e. largely though not solely bilateral) compared to the older/existing FTAs which had a preference for shallowness or narrowness in issue coverage but broadness in terms of membership[4].

Given that there is a limit to which lower income, developing countries are willing or able to go beyond the negotiation of frontier issues and seek deeper integration, this has inevitably meant that the new FTAs in Asia have been dominated by middle and upper income countries (Singapore, Thailand, Korea, etc), though other countries are also jumping on the bandwagon (Table 1). This is not an altogether surprising outcome. While neither theory nor empirics is able to offer definitive insight into whether there are any net benefits from a country being a member of FTAs, it is almost certain that a country that is not a participant in any of the new FTAs will be adversely impacted due to trade and investment diversion and reduction in their terms of trade. In other words, there is a strong case for joining FTAs for "defensive reasons" as "(F)TAs are like street gangs: you may not like them, but if they are in your neighbourhood, it is safer to be in one" (quoted in Crawford and Laird, 2001, p.201).

[3] These FTAs are therefore more appropriately referred to as Trade and Investment Facilitation Agreements (TIFAs).

[4] This is not to suggest that the older FTAs were in any way benign and completely open to newer members. For instance, the Asia Pacific Economic Cooperation forum (APEC), while not an FTA, set a moratorium on membership and showed no inclination to include other Asian countries such as Sri Lanka or India despite both countries having expressed interest in joining.

Formation of bilateral FTAs among such partners is also often viewed as a way of overcoming the so-called "convoy problem", whereby the pace of trade integration is held back by the "least willing member". Alternatively, as it is sometimes said, "those who can run faster should run faster and ought not to not be held back by those who choose not to run, or do so at a snail's pace". The surge of recent FTA initiatives may also be a means of building political momentum for other economies, regional alliances, as well as the World Trade Organisation (WTO) to hasten the process of liberalization and integration[5]. Simultaneously, to the extent that contracting parties to a FTA agree to move beyond their respective WTO commitments, there may be a demonstration effect that motivates future rounds of broader multilateral negotiations under the auspices of the multilateral trade body. Thus, one often hears policy makers in the region refer to their proposed FTAs as being "state of the art", "trail-blazing" or "WTO-Plus".

Another reason why countries like Singapore and Thailand have been rushing to form FTAs with a large number of different countries early on is to capitalize on being a hub of overlapping arrangements[6]. Producers in the hub have cost advantages vis-à-vis those in the "spokes", being able to obtain more of their intermediate goods at lower prices. Further, since exports originating from the hub are granted preferential access to a number of other markets, this may encourage the transshipment of goods via hubs, hence fortifying its already dominant role as an entrepot point. Of course, it is for this very reason that FTAs have special provisions or rules of origin (ROOs) which are meant to

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[5] Referred to as "competitive liberalization" whereby modest liberalization induces broader liberalization.

[6] See Chirathivat and Mallikamas (2004) and Nagai (2003) for discussions of the rationale behind Thailand's FTA strategy and developments thereof, and Rajan and Sen (2003 and 2004), Rajan et al. (2001) for the case of Singapore.

prevent goods being re-exported from the lower tariff country to the higher tariff country one (i.e. trade deflection). However, this in turn may lead to a shift of export platforms from other regional developing economies to the hub in order to benefit from duty-free market access; though care must be taken to ensure that ROOs are not manipulated in such a way that partners gain *de facto* protection for their goods in the hub market[7] (elaborated upon in the next section).

FTAs are also viewed as serving key diplomatic and security ends which may at times over-ride economic concerns. To be sure, there are some genuine economic concerns regarding the new FTAs which the next section highlights. Sections 3 to 5 move from the general to the specific and focus on ASEAN, which appears to be fast becoming the "hub" or centre of FTA activity, and its expanding economic linkages with China and India, the two most populous and dynamic economies in the world. Specific attention will be paid to ASEAN-China and ASEAN-India trade relations and the proposed FTAs between them. Section 6 concludes the paper with a discussion on intra-ASEAN economic integration in the context of the new regionalism in Asia. Annex 1 describes the Rules of Origin (ROOs) applied by some of the FTAs that Singapore is involved in.

2. The New Wave of FTAs in Asia: Areas of Concern

Contrary to popular belief and what many policy makers and trade negotiators might say, FTAs are by no means entirely benign. What are some potential concerns of this new regionalism? In some sense, the most important concern about FTAs is that they are, by definition, *preferential* and therefore discriminate against non-members.

[7] Even if ROOs are in place, there could be "indirect trade deflection" as low-tariff member could meet its requirements for a product from the non-members and export a corresponding amount of its own production to the members of the trade alliance.

However, abstracting from this and the perennial issue about trade diversion (which is of particular concern to high-tariff countries looking to form FTAs), the proliferation of a number of overlapping FTAs also raises some potential problems. We outline some of these concerns below.

2.1 Rules of Origin (ROOs)

An area of immediate concern pertains to the implementation of ROOs which are meant to prevent trade deflection. Even if ROOs do not prove to be *de facto* protectionist (Krueger, 1997a,b and Schiff et al., 2000), they are particularly complex, as definitions and methods of measurement can and do vary[8]. To illustrate this, Annex 1 highlights the various types and definitions of ROOs involving FTAs negotiated by Singapore. On one end of the spectrum, the city state's agreements with Australia and New Zealand are relatively simple, specifying that local value added should generally be between 30 and 40 percent. On the other end of the spectrum, the Singapore-US agreements details over 200 pages of product-specific ROOs. In some cases where the partner country's MFN tariffs are relatively low, businesses might quite logically choose to pay the partner countries' general tariff rates rather than attempt to obtain exemptions that Singapore-originating products might be entitled to.

In any event, the wide array of definitions used by just one country indicates the magnitude of the problems inherent with ROOs in a world characterized by multiple and

[8] There are three main methods of computing ROOs for manufactured goods: change in tariff classification; value added rule (local content rule), and process rule. Complications arise as a single FTA may include a combination of these computation methods. The value added rule could also vary depending on how value added is defined (inclusive of profits and inland transportation?). See Estevadeordal and Suominen (2003) for a comprehensive discussion on defining and measuring ROOs, their costs, and possible ways of harmonizing the various ROOs to promote multilateralism.

overlapping FTAs (for instance, see Estevadeordal and Suominen, 2003)[9]. Complying with the ROOs makes the costs of doing business prohibitively high and places significant burden on origin-certifying institutions. Implementation of ROOs provides opportunities for rent-seeking activities. This in turn negates one of the oft-noted rationale for FTAs, viz. to reduce transaction costs and enhance transparency so as to facilitate cross-border economic activity. As the current Deputy Managing Director of the International Monetary Fund (IMF), Anne Krueger, observed:

> It is difficult to imagine that a series of overlapping..(FTAs)…with different ROOs attendant for different countries' access, the need for individual producers to know and keep records for a variety of ROO requirements, and the complications associated with negotiations for accession of additional members, will lead to the WTO-plus world…The problems of proliferating overlapping…(F)TAs…deserve considerably more critical attention than they have so far received (Krueger, 1997b, p.22).

2.2 Scarce Negotiating Resources

Time and efforts spent on negotiating and implementing a web of bilateral and minilateral FTAs may redirect scarce resources from the multilateral rounds. Potentially more important than the direct impact of this "scarce negotiator resources argument" is the fact that by being involved in a number of FTAs, the country must accept at least partial responsibility for diverting attention of trade partners from multilateral negotiations. For instance, the US Trade Representative (USTR) paying more attention to a number of bilateral FTAs will mean that much less attention at the margin being paid to the WTO. A related point is that some less developed countries may lack the technocratic and institutional capacity to negotiate a number of FTAs. This appears to be the case in

[9] Bhagwati (1995) has coined the term "spaghetti-bowl" proliferation of preferential trading arrangements.

some ASEAN countries like Indonesia, Cambodia, Vietnam, Laos and Myanmar[10]. If these countries feel the pressure to negotiate FTAs quickly, they might end up agreeing to terms that may not necessarily be in their best interests (we return to this point below).

2.3 General Applicability of FTAs

Beyond the power asymmetry and scarce negotiating resources, small Asian countries like Singapore appear to be willing and able to negotiate FTAs fairly quickly as they seem ready to accept a number of conditions in the context of the bilateral pacts set forth by the larger partners. For instance, the proposed US-Singapore FTA includes non-trade issues such as those pertaining to capital account liberalization[11]. While acceptance of these conditions may not be problematic in the case of Singapore (given the city state's negligible agricultural sector and its strong financial institutions)[12], the presence of such linkages could imply that Singapore-based FTAs may not be an appropriate model for future trade arrangements. Indeed, referring to the US-Singapore trade agreement, Singapore's Minister of Trade and Industry, George Yeo, reportedly remarked:

> We have set high standards..I'm doubtful other countries can come up with these standards, because their economies are not as advanced as ours, but in any case, it should be something they should strive to achieve (quoted in Lien, 2002).

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[10] As apparent from Table 1, the bulk of ASEAN-related FTAs have involved Singapore and Thailand.

[11] This power asymmetry may also explain the non-standardization of ROOs among Singapore's FTAs. See Perroni and Whalley (1994) who formally show how large countries have dominated negotiations with FTAs with smaller countries (i.e. the former has the bargaining power in FTAs).

[12] Though Singapore itself needs to be concerned about possible inconsistencies between its various bilaterals, in contrast to Singapore, Mexico has tried to maintain a degree of uniformity in definition and computation of ROOs and other clauses in its various bilaterals by using the NAFTA agreement as a template (i.e. "NAFTA-consistent" agreement).

This is a key point. The initial spate of activity pertaining to FTAs has tended to involve many middle and high-income countries; most lower income countries have been left out in the cold. Thus, the current trend towards FTA among "like-minded" countries could exacerbate the development and policy divide between the richer and less well off countries and also lead to trade and investment diversion from the latter.

The lower income developing countries could always consider establishing a series of South-South FTAs. However, a recent World Bank report on trade blocs argued persuasively for the "superiority" of North-South FTAs to South-South ones for the following reasons (Schiff et al., 2000, pp.901):

a) South-South FTAs are more likely to generate trade diversion.

b) North-South FTAs are more likely to generate useful transfers of technology.

c) North-South FTAs are more likely to provide lock-in mechanisms in the area of politics (such as democracy) and economics (in terms of policy credibility).

d) Given the industrial partner's superior institutions, a North-South FTA may provide more benefits from "deep integration" than a South-South FTA.

e) Given a larger endowment difference between member countries in a North-South FTA than in a South-South one, a developing country may be able to better exploit its comparative advantage in a North-South FTA.

2.4 Building Block or Stumbling Block?

In the final analysis, the FTA approach to trade liberalization ought to be judged on whether it facilitates or hinders multilateral trade liberalization. This is an issue that has occupied academic economists for a long time. The analytical literature is inconclusive, while the empirical literature far too unreliable to make any definitive judgments.

On the one hand, FTAs may be a stumbling block if preferential access gained by some reduces the motivation or incentive to liberalize multilaterally. Related to this, countries that are members of FTAs may take the view "(i)f we do not get what we want in the..multilateral..negotiating agenda, why should be worry? We have our own FTA. That is where the action is!" (Crawford and Laird, 2001, p.207)[13]. This attitude has the potential to weaken the multilateral trading system even further.

On the other hand, the fact that the new regionalism tends to involve multiple memberships in various FTAs and has been driven by some of the more open economies in Asia (Singapore, Thailand, etc.), offers hope that regionalism will not be a stumbling block to multilateral liberalization. These is probably among the key differences between the new wave of FTAs and the older ones which tended to have a strong protectionist bias and were thus not conducive to promoting overall growth. However, there is another side of the coin nicely expressed by Hadi Soesastro (2003):

> What has developed thus far in East Asia is a sense of "competitive confusion" as it becomes more and more apparent that East Asian countries do not have a clear idea about the dynamics of the processes, specifically the risk of trade fragmentation and political tensions resulting from the un-coordinated processes. The fact that more and more countries are contemplating to join in the FTA game for defensive reasons signals a clear and present danger. Even with the few agreements that have been concluded it also becomes more and more apparent that linking them is rather complicated matter…(T)hey might not become stumbling blocks to region-wide or global free trade, but they do not necessarily become building blocks either. Rather they may end up being simply "bumbling blocks" (pp.1-2).

[13] This attitude further stems from the fact that possible risks of any FTA to be legally deficient or "inconsistent" with the WTO is virtually non-existent, since the current WTO review process that examines these FTAs for consistency has become ineffective (Stoler, 2004).

The foregoing quotation mentioned the proliferation of FTAs due to "defensive reasons". This point deserves elaboration. Notwithstanding repeated "assurances" by policy makers that their FTAs are not exclusive and are open to accession by any country which agrees to the terms of the agreement, in most cases it is likely that the new or potential member must be prepared to join the existing FTAs at the prevailing terms (which may not be in the potential members' best interests). In a quest to gain the benefits from being secondary hubs, existing FTA members as well as non-members will see it in their best interests to create a number of distinct FTAs; there will be little incentive for expansion and consolidation of existing FTAs as this would diminish the value of their existing preferential access[14]. This "domino effect" will result in an ever more complex array of overlapping hub-and-spokes arrangements with different ROO requirements -- this is already happening now[15]. Therefore, it is rather unlikely that such FTAs will, on their own, lead to systematic liberalization on a multilateral (MFN) basis as this in turn would require an amalgamation of existing FTAs rather than a multiplication of smaller ones.

3. The Economic Rise of China and India

As noted, many ASEAN members (such as Singapore and Thailand) have embraced the new regionalism, as has ASEAN as a whole. Of particular interest is the

[14] While spokes are certainly worse off in a hub-and-spoke regime compared to a "full" or complete FTA, it is unclear whether hubs are unambiguously better off. This is so, as the collective income of a hub-and-spoke arrangement tends to be smaller (given the inefficiencies caused by overlapping FTAs), the share of benefits accruing to the hub is larger than a full FTA (Wonnacott, 1996a,b).

[15] Note that Baldwin (1997) used the term "domino regionalism" to refer to a phenomenon whereby the incentives to join an FTA rise as it gets larger.

proposed ASEAN FTAs with China and India, the two continental sized Asian dynamos. Singapore's Prime Minister, Goh Chok Tong, has observed that the "ASEAN jumbo jet has one wing in the making in the East, through agreements with China and Japan. India…provides the second wing. With this, we can take off" (The Straits Times, Singapore, November 6, 2002). Both China and India have acceded to the 1976 Treaty of Amity and Cooperation in Southeast Asia (TAC) as a means of furthering peace and stability with ASEAN, and are engaging ASEAN constructively in all spheres.

China has been opening up its economy to the outside world in a carefully managed and phased manner since 1979. China's economy has grown at an annual average rate of about 8.5 percent between 1990 and 2000, and its merchandise exports have expanded by more than 15 percent annually over the same period[16]. With China's phenomenal output and trade growth over the last two decades, it has emerged as a major economic power in Asia. China is the most populous country in the world, the second largest economy in terms of GDP at Purchasing Power Parity (PPP), the world's fifth biggest merchandise trading nation (5 percent share of global merchandise exports), the tenth largest global exporter of commercial services (2.5 percent share of world service exports), and the largest recipient of Foreign Direct Investment (FDI) among developing countries if not the entire world. China's accession to the World Trade Organization (WTO) in December 2001 appears to have given a further fillip to the country's FDI, exports, and overall growth prospects over the medium and longer terms. This said, there remain persistent concerns about overheating, rigid currency, relatively weak and inefficient banking sector, and the sustainability of liberal economic policies in the absence of any significant political reforms.

[16] It is generally acknowledged that official growth figures in China may be slightly exaggerated.

India too is fast emerging as a significant growth pole in Asia. India is the second most populous in the world, its economy is ranked fourth largest in terms of GDP at PPP, and it is becoming a favoured destinations for FDI, particularly relating to Business Processing Operations (BPOs). In just a few years since external liberalization, India has become the world's 19th largest service exporter (1.5 share of global service exports)[17]. Following the initiation of economic reforms in India in 1991 and their continued implementation -- albeit in a rather ad hoc and quiet manner (i.e. reform by stealth) -- India's annual growth rate has been among the world's fastest (Figure 1) and the country represents a compelling macroeconomic story, with potential to sustain high economic growth rates over the medium and longer terms.

According to Huang and Malkini (2004) of the Citibank:

> The likely regional and global impact from China and India will be unmatched by any other Asian economy. With 39 percent of the human population and 23 percent of the global economy, on PPP measures, China and India already contribute more than 20 percent of global GDP growth every year.

According to Stephen Roach (2004) of Morgan Stanley:

> It's tempting to make the China-India comparison .. I see no reason to frame this in such black and white terms .. I am inclined to argue that it's not China or India but, in fact, China *and* India. Each of these two nations has a distinctly different recipe for economic development – recipes that are complements rather than substitutes as they fit into the broad mosaic of globalization.. China has an outward-looking development model .. India has much more of a home-grown development model that is now gaining global reach .. I have long been a big fan of China's remarkable accomplishments. India's awakening is equally impressive[18].

Some analysts have projected – somewhat optimistically – that India will emerge the third largest economy in 2003 dollars by the year 2050, only behind China and the US

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[17] India's global merchandise export share is only about half that.

[18] Also see Huang and Khanna (2003) for a discussion of differences in development strategies between India and China.

(Morgan Stanley, 2003, Purushothaman, 2004 and Wilson and Purushothaman, 2003). Nonetheless, the fact that such forecasts are being made independently by leading and reputed private research firms indicates the rapidly changing perceptions about, and extremely bullish expectations of, the Indian economy over the last few years. Part of the bullish long-term growth forecasts for India arises from the broad-based support for economic reforms by all major political parties in India, as well as the fact that India is the last major country in Asia to undergo a significant demographic transition, with an expected bulge in working population expected by 2020. It appears that the West has embraced the India growth story far more enthusiastically than have India's East Asian neighbours, largely due to perception and information gaps and ideological biases. Like China, however, India has a number of areas of concern that might hinder it from fulfilling its enormous economic potential. In India's case, areas that require firmer action include fiscal consolidation (particularly at the state level), further opening up for the trade and investment sectors (in a graduated and sequenced manner), improvements in infrastructure and reforms of labour and bankruptcy laws, and significantly enhancing delivery mechanisms (i.e. closing the yawning gap between policy pronouncements, on the one hand, and action/implementation, on the other).

The next two sections examine the extent of ASEAN's trade linkages with China and India.

4. ASEAN-China Trade Relations and the ASEAN-China FTA[19]

[19] Section 4 draws partly on Rajan (2003b) and Srivastava and Rajan (2004).

What are the implications for China's economic emergence for ASEAN? On the one hand, many ASEAN economies are expected to face particularly intense competitive pressures from China in view of the overlap in relative factor endowments, export markets (the US), and heavy reliance on FDI inflows from similar sources. On the other hand, the rapid growth of China over the past decade or more offers the region potentially lucrative opportunities in terms of exports, in-bound tourists and third-country trade and investment collaborations.

By way of background, the remainder of this section examines broad trends in trade and investment relations between China and ASEAN, commenting upon the likely impact of these relations on ASEAN due to China's economic rise, and then goes on to consider the proposed ASEAN-China Free Trade Area (ACFTA) which is viewed as a means of institutionalizing and deepening ASEAN-China trade and investment ties.

4.1 Trends and Patterns in ASEAN-5 and China Trade[20]

a) Merchandise Trade

Figure 2 reveals trends in bilateral trade between ASEAN-5 and China between 1985 and 2001. Bilateral trade rose quite pointedly between 1992 and 1996. This period corresponds to a time when FDI began to surge into China. Expectedly, trade between the two stagnated between 1996 and 1998 during the economic crisis in Southeast Asia, though it has rebounded since then. Bilateral trade between ASEAN-5 and China totaled US$ 39.5 billion in 2002, growing at an annual average of slightly over 20 percent since 1991 when overall trade amounted to only US$ 7.9 billion (ASEAN-China Expert Group

[20] Given data limitations, the focus will be mainly on the founding ASEAN-5 members, viz. Indonesia, Malaysia, Philippines, Singapore and Thailand.

on Economic Cooperation, 2002). While both ASEAN's exports to and imports from China have increased in tandem, the latter has consistently exceeded the former, ensuring that China has enjoyed a persistent trade surplus with ASEAN.

Available data for 1993, 1996 and 2001 indicate that China's share has trebled in both ASEAN's exports as well as imports in 2001 compared to 1993 (Figures 3a,b,c and Figures 4a,b,c). In 1993, China accounted for about 2 percent of ASEAN's total trade (exports and imports) and was ASEAN's seventh largest trading partner. By 2001, China accounted for nearly about 6 to 7 percent of ASEAN's total trade and became ASEAN's fifth largest trading partner. The increase in share was particularly significant in the latter half of the 1990s.

Tables 2 and 3 present the top ten exports and imports in ASEAN's trade with China in 1993, 1996 and 2001. In comparison to 1993, when ASEAN's exports to China were dominated more by primary products like Wood & Wood articles and Mineral Fuels, the product composition shifted markedly by 2001 to manufactured products, particularly Electrical and Electronic and Machinery and Mechanical Appliances (including Nuclear Reactors, Boilers, Machinery, and their Parts). This is evident in the increasing share of these products in ASEAN's exports to China over the 1993-2001 period. These products accounted for more than half of ASEAN's imports from China by 2001. All in all, there is increasing evidence of intra-industry trade in these products between ASEAN-5 and China (Wong et al,, 2003 and Zebregs, 2004).

Despite the rapid growth in both exports and imports between ASEAN and China, there have been persistent concerns that China's rise has been and will continue to be at ASEAN's expense. However, this is inconsistent with the theory of comparative advantage, particularly when one considers the possibility of product differentiation, wherein within each product category, goods could be differentiated according to quality and brand (horizontal differentiation), or they could be further differentiated into sub-parts and components with differing factor intensities (vertical specialization). As such, even if any ASEAN country's factor intensities happen to broadly coincide with the various regions in China, it can still develop its own export market niche by specializing in differentiated products.

This said, a concern about China's ascendancy and price competitiveness is that "cheap Chinese imports" will keep the price pressures on imperfect substitutes down, i.e. other countries will import price deflation from China with consequent depressing effects on business margins and factor returns, including wages. It is in this sense that ASEAN countries may have complementarities with China in production and export structures (i.e. vertical specialization), while other parts are simultaneously competitive (horizontal specialization). These global competitive pressures emanating from China and the potential deflationary effects are of particular concern in the areas of textiles and clothing where China's WTO accession is expected to be a significant boon to Chinese exporters who are no longer limited by the quantitative restrictions under the Multifiber Arrangement (MFA) (Adhikari and Yang, 2002 and Martin and Ianchoviachina, 2001).

In addition, with China's continued opening up and the growth effects spreading to the inland regions, there are real concerns that small variations in costs could lead to large shifts in comparative advantage thus necessitating large and sudden domestic adjustments[21]. Countries need to be ever aware of these potential costs shifts and ensure

[21] Bhagwati (1997) refers to this phenomenon as "kaleidoscope" or "knife-edge" comparative advantage where margins are often wafer thin.

constant industrial upgrading so as to remain important cogs in the larger regional production network. In other words, the continued opening of China may well contribute to a far more uncertain and competitive environment for ASEAN countries (especially as China's western regional develop and labour intensive industries migrate to the inland regions). Conversely, accession to the WTO ought to offer even more benefits to regional countries as it would involve increased access to the Mainland's domestic market, allowing ASEAN countries the possibility of enhancing exports. Thus, while China has remained an important import source for ASEAN, as discussed previously, it has also become an increasingly important export market, as indicated by the concomitant rise in its share of ASEAN's total exports. If current trends persist, the growing importance of China may well provide a much-needed cushion to smaller ASEAN countries against gyrations in the industrial country economic environment[22].

b) Services Trade

With services trade gaining importance in world trade and in China and ASEAN as indicated in the previous section, it is essential to also consider the complementarities and competition in the services sector between them. Indeed, trade liberalization in services is an important dimension of China's WTO accession. As Mattoo (2002) notes:

> (China's) GATS commitments represent the most radical services reform program negotiated in the WTO..(China)..has promised to eliminate over the next few years most restrictions on foreign entry and ownership, as well as most forms of discrimination against foreign firms (p.22).

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[22] Conversely, ASEAN economies are becoming much more susceptible to the possibility of a hard landing in the Chinese economy which has shown signs of overheating in recent times.

With WTO accession there will be greater scope and demand for services by China, particularly with regard to distribution, professional and infrastructural services (telecommunications and financial). As China continues to rapidly urbanize and industrialize, there will invariably be vast opportunities for ASEAN businesses to be involved in major infrastructural development projects. Thus, richer and more developed ASEAN countries such as Singapore and Malaysia, which have growing strengths in these areas, should benefit significantly from China's continued economic transformation.

Unlike merchandise trends, detailed data on bilateral services trade data between ASEAN and China are unavailable. However, anecdotal evidence indicates that with respect to China and ASEAN-5, there appears to be greater potential for cooperating in Travel and Tourism services in view of the strong comparative advantage that most ASEAN-5 economies enjoy in this area[23]. China is the world's fastest growing tourist market in both inbound and outbound travel. Two way flows between ASEAN and China have been on the rise. ASEAN tourists visiting China totaled almost 1.1 million in 1995; the number reached an estimated 1.8 million in 2000. While ASEAN–5 received about 0.8 million tourists from China in 1995, this number almost tripled to 2.3 million persons in 2000. Conversely, ASEAN tourists were less than 8 percent of the total tourist arrivals (19.8 million) to China during 1999, while Chinese tourists in ASEAN made up just 10 percent of the 22.6 million persons visiting ASEAN in 2000 (Wattanapruttipaisan, 2002).

Trends in visitor arrivals from China to ASEAN indicate that the total number of visitors has increased to 2.8 million (6.4 percent of total visitors) in 2002 (Table 4).

[23] Travel and tourism constitute slightly over 8 percent of ASEAN's GDP and over 7 percent of the region's employment (Wu et al., 2002).

Between 1996 and 2001, the share of Chinese visitors to ASEAN increased from 4.1 percent to 5.8 percent of total tourist arrivals (Figures 5a and b). In general, Thailand attracted more than a quarter of all Chinese visitors to ASEAN, followed by Vietnam, Singapore and Malaysia. The growth in tourists from China was particularly significant in Malaysia and Singapore, where Chinese visitors increased from the 10th largest visitor group in 1995 to 4th and 5th positions, respectively in 2001 (Wu et al., 2002). Between 1995 and 2001, the number of Mainland Chinese visitor arrivals to Malaysia quadrupled, while they doubled to Thailand and Singapore. According to the ASEAN Secretariat data, China ranked among the 3rd largest visitor-generating market for ASEAN in 2002 (after Singapore and Japan).

A number of ASEAN countries such as Malaysia, Thailand and Singapore are taking specific steps to enhance their attractiveness as tourist destinations to Mainland Chinese residents. More can be done in this regard, particularly with ASEAN countries working in tandem or as clusters to promote the region as a whole (also see Wu et al., 2002). There have been important initiatives in this direction, with an announcement recently by the ASEAN Secretariat that ASEAN planned on forging closer tourist relations with China, Japan and Korea.

4.2 The ASEAN-China Free Trade Agreement (ACFTA)

Recognizing the benefits of cooperation and integration on a wider scale, the former Chinese Premier, Zhu Rongji, mooted the idea of the ACFTA during the ASEAN-China Summit in November 2001[24]. After a series of negotiations, the so-called ASEAN-

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[24] There are undoubtedly political economy rationale behind China's ACFTA proposal, including wanting to alleviate concerns that ASEAN leaders have about the growth of China (and its impact

China Closer Economic Partnership Framework Agreement was given concrete shape during the ASEAN Summit in Cambodia in November 2002.

A key feature of the ACFTA agreement is the "early harvest" clause, which commits ASEAN and China to reduce their respective tariffs for certain products by January 2006. These early harvest products are mainly agricultural products that represent about 10 percent (or more than 600) of all tariff lines in the Harmonized System (HS) of tariff classification[25]. The timetable for elimination of tariffs in the "normal track" is from January 2005 to January 2010 for ASEAN-6 and until January 2015 for the CLMV countries (i.e. Cambodia, Laos, PDR, Myanmar, and Vietnam). The framework agreement identified five priority areas for economic cooperation apart from trade liberalization and facilitation measures. These are agriculture, human resource development (HRD), information and communication technology (ICT), investment and the Mekong River basin development. China has agreed to implement capacity building programs and provide technical assistance for the CLMV countries to catch up with the middle income ASEAN members.

The ACFTA ought to reduce transactions costs of cross-border trade and ensure that the procurement of parts and components can be done in the region efficiently, hence benefiting all countries involved in the regional production network. The creation of the ACFTA also effectively raises the costs of engaging in conflict among the countries

on the rest of Southeast Asia – zero sum game?), as well as to make inroads into ASEAN relative to Japan (i.e. some have argued that both China and Japan are competing to bring Southeast Asia within their respective "spheres of influence").

[25] The early harvest products include Live animals. Meat and edible meat offal, Fish, Dairy produce, Other animal products, Live trees, Edible vegetables, and Edible fruits and nuts (MTI, 2002).

involved and offers more systematic procedures and avenues to negotiate areas of dispute, thus possibly contributing to greater regional stability. This said, while the ACFTA ought to speed up the growing mutual interdependence between ASEAN and China, the impact of the ACFTA on individual ASEAN member economies is likely to be felt differentially depending upon the extent to which its economic structure and composition of trade complements or competes with that of China (ASEAN-China Expert Group on Economic Cooperation, 2001 and Roland-Holst et al. (2001). Indeed, it appears that while Thailand and Singapore are particularly keen on implementing the ACFTA sooner rather than later, Indonesia and the Philippines are rather reluctant participants. ASEAN economies will undoubtedly be faced with significant adjustments from closer integration with China. The challenge for the policy makers is to assist in the retooling of workers to ease the transition.

This said, an immediate positive side effect of the ACFTA proposal is that it appears to have raised the awareness of ASEAN countries of the need to hasten the process of intra-ASEAN integration, including advancing the completion date of the ASEAN Free Trade Area (AFTA) (we will more to say about intra-ASEAN integration in Section 6). The ACFTA has also had positive / domino effects; after years of being seen as an ineffective talk-shop, ASEAN is back in the center stage. Thus, other major economic powers in Asia like India are also seeking out trade pacts with ASEAN. We consider ASEAN-India relations next.

5. ASEAN-India Trade Relations and the ASEAN-India FTA[26]

The scope and density of relations between India and ASEAN has been steadily rising since India adopted its "Look East" policy in 1991 (Shahin, 2003). India became a *sectoral* dialogue partner of ASEAN in 1992 (the sectors were trade, investment, tourism and science and technology). It was only in December 1995 that India was invited to become a *full* dialogue partner of ASEAN during the Fifth ASEAN Summit in Bangkok and granted membership in the ASEAN Regional Forum (ARF) (which focuses on security issues) in July 1996. An important milestone was achieved with the hosting of the first ASEAN-India summit in Phnom Penh, Cambodia in November 2002 (Gaur, 2003). Commenting on India's "Look East" policy, India's former External Affairs Minister, Yashwant Sinha, is quoted as saying:

> In the past, India's engagement with much of Asia, including Southeast and East Asia, was built on an idealistic conception of Asian brotherhood, based on shared experiences of colonialism and of cultural ties. The rhythm of the region today is determined, however, as much by trade, investment and production as by history and culture. That is what motivates our decade-old 'Look East' policy. Already, this region accounts for 45 percent of our external trade (quoted in Shahin, 2003).

By way of background, this section first examines broad trends in trade relations between India and ASEAN and then goes on to discuss the ASEAN-India Free Trade Agreement.

5.1 Trends and Patterns in ASEAN-5 and India Trade

a) Merchandise Trade

Figure 6 reveals trends in bilateral trade between ASEAN and India between 1993 and 2001. While ASEAN's exports to India increased four-fold continually from US $

[26] Section 5 partly draws on Sen, Asher and Rajan (2004).

1.5 billion to US $ 6.2 billion over this period, its imports from India more than doubled from US $ 1.4 to US. 3.7 billion over the same period. ASEAN's imports from India also registered a continuous increase other than during the crisis years of 1997-98. India's position has also been consistently improving in the trade basket of ASEAN-5 over the past decade. Available data for 1993, 1996 and 2001 indicates that India's share has more than doubled from (0.7 to 1.7 percent) in ASEAN's exports in 2001 compared to that in 1993 (Figures 3a,b, c), while its share in ASEAN's imports has also doubled (from 0.6 to 1.2 percent) over the same period (Figures 4a,b, c).

Tables 5 and 6 present the top ten exports and imports in ASEAN's trade with India in 1993, 1996 and 2001. In comparison to 1993, when ASEAN's exports to India were dominated more by primary products like Mineral Fuel Oils waxes & Products, etc., the product composition shifted markedly by 2001 to manufactured products, particularly Electrical and Electronic and Machinery and Mechanical Appliances (including Nuclear Reactors, Boilers, Machinery, and their Parts). These products, along with that of Animal Vegetable Oil, fats and waxes, accounted for about a half of ASEAN's exports to India by 2001. ASEAN's imports from India have also exhibited a similar shift in product composition from primary to manufacturing products over the period, with Electrical and Electronic and Machinery and Mechanical Appliances (including Nuclear Reactors, Boilers, Machinery, and their Parts) accounting for more than a quarter of ASEAN's total imports from India in 2001. Light manufactured products viz. Natural or cultured pearls and precious/semi-precious stones and jewellery thereof, also constituted a significantly increasing proportion of imports from India over the period. All in all, as in the case of

ASEAN's trade with China, it appears that there is increasing evidence of intra-industry trade in manufacturing products between ASEAN-5 and India as well.

b) Services Trade

While merchandise and services trade expanded at almost the same rate between 1980 and 1989 (9 percent), the average annual growth of services trade over the 1990-00 period has been more than twice that rate. India's share in Asia's exports of commercial services (as defined by the WTO) increased from 3.5 percent to 7.3 percent between 1990 and 2002. India's share in world trade of commercial services in 2002 was higher than Malaysia, Indonesia and the Philippines, and almost about that of Singapore (WTO, 2003, Table I.7).

The Information and Communication Technology (ICT) and related services have constituted the major driving force behind services trade in India. The development of this sector has been primarily market-driven; government regulation has been minimal. The growth of this sector has been propelled by the nurturing of a pool of skilled ICT manpower, combined with an increasing international demand for such competitive and skilled manpower. However, in spite of rapid growth, India's share in the global software market is still small. While the software industry in India is diversifying into new areas with stronger growth potential like Applications Service Providers (ASP), e-commerce and related applications, the hardware industry is only beginning to receive the requisite attention of the policymakers and the industry. This is an area where India needs to develop capabilities in order to be a truly global player in the electronics and information technology (IT) sectors. Cooperation with ASEAN economies that have developed such capabilities, particularly Singapore and Malaysia, could create synergies for mutual benefits in this area.

India has become the leading destination for outsourcing of ICT services, call center support and other back-end business process operations (BPOs) like data entry and handling, payroll management, accounting and book-keeping, processing of tax returns and insurance claims, ticketing, coding and organizing of documents for major litigation cases, transcription (medical and legal). Many US, British and other multinationals as well as smaller enterprises routinely outsource a number of their services activities. They have come to appreciate that if they do not outsource to reduce costs, while their competitors continue to do so aggressively, they stand to lose global and local market shares to their foreign rivals. The resultant stagnant corporate profit growth will limit the creation of new capital and re-investment in domestic technology.

India has gained a competitive edge as an outsourcing hub for a number of reasons, including the widespread use of English, internationally competitive wages, large pool of science and engineering graduates, and the presence of strong indigenous service sector enterprises. Outsourcing to India in particular has not only involved low-to-mid skill areas like call centres and routine data-crunching tasks, but also more sophisticated and skills-based services including software development, research and development (R&D), financial portfolio analysis, patent writing and product design and development. ASEAN corporations have been rather slow and timid in utilizing India's strengths in outsourcing, design, and research and development to enhance their global competitiveness as aggressively as their Western counterparts. ASEAN companies have thus chosen to forgo the potential competitive advantage by not locating some part of the value-chain in India. This is a source of synergy which needs to be tapped, but is contingent on a change in the mindset of the ASEAN media and the elites.

Another area of services trade that holds potential for expansion is tourism. Indonesia, Malaysia, Philippines, and Singapore have already developed considerable expertise and competitive advantage in tourism, with Vietnam also developing into an important tourist destination in recent years. However, India has realized the potential in this area rather belatedly and is taking steps to implement an integrated tourism industry. India aims to not only attract substantially larger number of international visitors than the current 2.75 million tourists in 2003, but also provide a conducive atmosphere and money-for-value services to increase their stay and expenditure per day[27].

Trends in visitor arrivals from India to ASEAN indicate that the total number of visitors has increased from about 420,000 in 1992 to over 880,000 (2.0 percent of total visitors) in 2002 (Table 7). Between 1996 and 2001, the share of Indian visitors to ASEAN increased from 1.4 percent to 1.8 percent of total tourist arrivals (Figures 5a and b). In general, Singapore attracted nearly half of all Indian visitors to ASEAN, followed by Thailand, Malaysia and Indonesia. According to the ASEAN Secretariat data, India ranked among the tenth largest visitor-generating market for ASEAN (excluding intra-ASEAN visitors).

In contrast, the flow of ASEAN visitors to India is quite small. In 2001, visitors from ASEAN countries to India numbered only about 140,000, less than one-fifth of that of Indian tourists visiting ASEAN. Country-wise, visitors from Malaysia constituted the highest share of ASEAN visitors to India (41 percent), followed by Singapore (31

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[27] The average length of stay of international tourists is 29 days. Thus, in 2003, India received 80 million nights of visitors per year, a fraction of its potential.

percent), and Thailand (13 percent). The share of business travelers from key ASEAN countries, such as Singapore, has been growing. In 2003, about 35 percent of visitors from Singapore to India traveled on business visa (Aggarwal, 2004). This indicates that the balance of trade in tourism services is likely to significantly favour ASEAN countries. India needs to be more proactive in attracting visitors from ASEAN (Sen, 2002).

Several important developments in the tourism sector concerning ASEAN and India have taken place recently. During the Bali Summit, India offered unilateral liberalization of air travel for ASEAN carriers. ASEAN air carriers have been permitted to fly to 21 tourist destinations in India directly. In addition, ASEAN air carriers can now fly to 4 metros in India without any limit during the busy tourist months. This is expected to be of significant benefit to the national carriers from Malaysia, Thailand and Singapore. The budget carriers of Malaysia and Thailand, and hopefully Singapore are also planning to fly to India. Indian domestic carriers have been given permission to fly to destinations on the Indian subcontinent, and the geographical reach may be extended in due course. This offer has subsequently led to greater connectivity between India and ASEAN, though there is considerable scope to increase it further. Increased competition is likely to reduce airfares between India and ASEAN, currently among the highest on a per-mile basis. The granting of visa-on-arrival facilities for Indian visitors to Thailand, and more recently by Malaysia are further measures that could enhance such interactions.

All in all, the tourism industry in India has the scale to become a competitive industry, provided appropriate investments, infrastructure, human resources, and service-oriented mindset are developed. This is a major challenge facing India's tourism sector.

5.3 The Proposed ASEAN-India Free Trade Agreement

Indian policy makers are well aware that the existing volume of trade with ASEAN is relatively low and needs to be augmented. It is therefore pursuing a policy of speedy alignment of its tariff levels with the ASEAN countries. In 2000, India's average tariff rate was about 29 percent compared to an average of 10-12 percent for ASEAN. However, India has already committed itself to progressively making tariff levels comparable with those in ASEAN by 2007 (Kumar, 2002). In addition, customs procedures have also been simplified to further reduce cross-border transaction costs (Business Standard, 2004). Both these will have a positive impact in facilitating trade.

In addition, India signed a framework agreement for the creation of a FTA with Thailand in October 2003 to be fully implemented by 2010. India has been engaged in negotiations to form a Comprehensive Economic Cooperation Agreement (CECA) with Singapore. Sub-regional cooperation between India and some of the ASEAN members such as Vietnam, Thailand, Myanmar, and Laos has also accelerated (Gaur, 2003 and Suryanarayana, 2003). These include the Mekong-Ganga Cooperation (MGC) and the BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation).

The recent bilateral and sub-regional efforts to strengthen economic relations are being complemented through an effort by India to intensify its economic relations with ASEAN as a whole. Thus, a Framework Agreement on establishing a FTA between ASEAN and India was signed by India's former Prime Minister, Atal Bihari Vajpayee, during the Second ASEAN-India Summit in Bali in October 2003. Like the ACFTA, the ASEAN-India FTA is expected to encompass a strategic and political partnership, going well beyond a traditional FTA agreement. With the signing of the framework trade agreement between India and ASEAN, there is now a clear institutional framework for operationalizing economic cooperation between them. Once established, this agreement is expected to link India even more closely with ASEAN. The aim is to increase bilateral merchandise trade between ASEAN and India to US$ 15 billion by 2005 and to US$ 30 billion by 2007. These appear to be rather ambitious targets but nevertheless useful ones to aim towards.

As with the ACFTA, the ASEAN-India FTA provides for an early harvest program which will start from November 1, 2004. This program specifies the areas for collaboration and a common list of items for preferential tariff concessions. According to this Framework Agreement, the deadline for negotiations for an ASEAN-India FTA in goods would be between January 2004 and June 2005, and for services and investments between 2005 and 2007. It is envisaged that formal tariffs on non-agricultural goods will essentially be eliminated for the original ASEAN members except for the Philippines by 2011, with the CLMV countries reciprocally eliminating tariffs for India with effect from 2016. India has also agreed to extend unilateral tariff concessions to the CLMV countries on 111 items to extend special and differential treatment to the newer ASEAN members, based on their levels of development. India and Philippines have agreed to eliminate tariffs on a reciprocal basis only by 2016.

The Framework agreement also aims to broaden and intensify joint efforts at economic cooperation between ASEAN and India in the Mekong Basin by promoting the Mekong-Ganga Cooperation (MGC) program that spans many of the newer ASEAN member countries. The enhancing and building up of transport links that span India, Myanmar, Thailand, Cambodia and Vietnam is one of the major goals of this program. One of the major visions of this program is to establish a Delhi-Hanoi road and railway link in the near future.

6. Concluding Remarks: Implications for ASEAN

The new regionalism in Asia has given rise to a highly complex and rather untidy patchwork quilt of trading agreements. While the overall welfare effects of Asia's new wave of trade agreements remain in doubt, ASEAN is potentially well placed to reap benefits of being the *de facto* hub. The three largest countries in Asia, viz. China, India and Japan, are due to fully implement FTAs with ASEAN by 2010, 2012 and 2011, respectively. South Korea, Australia and New Zealand have also actively courted ASEAN recently, as has the US. Nonetheless, for ASEAN to capitalize fully on its *de facto* hub status, greater efforts need to be expended to maintain cohesion and deepen intra-ASEAN integration. ASEAN needs to focus specifically on making the region a seamless and enlarged production base.

A recent McKinsey Consulting report on ASEAN stresses three significant concerns that investors have expressed about ASEAN (Schwarz and Villinger, 2004): (a) subscale and fragmented markets; (b) unnecessary costs due to different product standards and customs procedures; and (c) unpredictable policy implementation by ASEAN, including the recent back-tracking by some countries on their AFTA commitments. According to McKinsey, deeper integration could shave almost one-fifth of total costs of production in ASEAN. Singapore's Prime Minister, Goh Chok Tong, highlighted the limitations of existing integrationist shallow arrangements such as AFTA which came into force on January 1, 2002[28]:

> (F)eedback from businesses is that we have not done enough. Traders have made limited use of the preferential treatment under AFTA. Only a small percentage of intra-ASEAN trade is conducted under AFTA. Regional sourcing remains low. For example, only 18 percent of personal care products and 5 percent of food are sourced regionally. In contrast, in the EU, the corresponding figures are 50 percent and 25 percent respectively. This striking difference shows that while we have made commendable progress in tariff reduction, we are far from an integrated market..(I)t is too costly to apply for preferential tariffs in some ASEAN countries. Companies would rather pay more, than put up with red tape and delays that they would encounter if they applied for preferential treatment under AFTA (Goh, 2002, pp.2-3)[29].

ASEAN leaders appear to have taken this feedback seriously. In October 2003 at the Bali summit, they agreed to the goal of creating an ASEAN Economic Community (AEC) by 2020 (so-called "Bali Concord II")[30]. The primary objective of the AEC is to deepen and accelerate intraregional economic integration by liberalizing trade, investment and skilled labour flows and addressing behind-the-border barriers. Specific

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[28] In a nutshell, the cornerstone of the AFTA is the "Common Effective Preferential Tariff" or CEPT percent. The CEPT is a mechanism whereby intra-regional tariffs on "most goods" (which meet a 40 percent content requirement) are supposed to have been reduced by 0 to 5 percent by 2003 for the original six ASEAN members, and by 2006 for Vietnam and 2008 for Laos and Myanmar and 2010 for Cambodia. There are a couple of reasons for the relative ineffectiveness of AFTA. One, is the number of exceptions allowed from the CEPT scheme ("temporary exclusion", "sensitive agriculture exceptions" and "general exceptions"). Indeed, the goal of bringing down the average tariff rates for at least two-thirds of their CEPT products to zero (agreed to in the Hanoi Plan of Action), has not been realized by all of the ASEAN-6 members. The result has been that the CEPT rate differs little from the MFN rate, providing little impetus for interregional trade. Two, is the backsliding in commitments by some member countries (e.g. Malaysia in the case of motor vehicles and parts; Indonesia in agricultural products; and the Philippines in the case of petrochemical products). The other parallel regional integrationist program, viz. the ASEAN Investment Area (AIA) scheme, has been even more disappointing.

[29] As noted in the footnote above, the utilization of the concessions under CEPT has been quite low also because of low margins of preference (between the CEPT and MFN rates).

[30] More generally, they embraced the notion of an "ASEAN Community" in general, which is to be based on three pillars of political and security cooperation, economic cooperation, and socio-cultural cooperation.

initiatives suggested by a High-Level Task Force (HLTF) to move the AEC concept forward in the next few years include: fast-track integration of eleven priority sectors[31]; hasten customs clearance and simplify customs procedures; eliminate existing tariff and nontariff barriers to trade; accelerate the implementation of the Mutual Recognition Arrangements (MRAs) for key sector such as electrical, electronic and telecommunications equipment; and harmonize standards and technical regulations; and create a more effective ASEAN Dispute Settlement Mechanism (DSM) (Goh, 2003, Ong, 2003 and Hew and Soesastro, 2003). There is also a need to strengthen institutions such as the ASEAN Secretariat to propel deeper economic integration.

This said, there remain a number of skeptics about the effectiveness of ASEAN as an economic entity (as opposed to a political one) and its ability to act more concertedly to advance its own regional integration. The vast and growing income gaps and heterogeneity among the various members may well act as a road-block to deeper economic intra-ASEAN integration in the near term, and could also limit the ability of the association to develop a common strategy to deal with extra-regional countries. Indeed, while ASEAN as a group is engaged in negotiations with China and India, Thailand and Singapore -- which are the two most enthusiastic liberalizers in ASEAN -- are negotiating separate comprehensive agreements with these two entities as they are concerned about the slow pace of negotiations and implementation of ASEAN-wide agreements.

[31] The priority sectors are: automotive, wood-based products, rubber-based products, textiles/ apparels, agro-based products, fisheries, electronics, air travel, tourism, ICT/e-commerce and healthcare.

Clearly, just as some ASEAN countries prefer to take a more graduated approach to liberalization (as they aim to balance domestic economic priorities and promote their external economic interests), Singapore and Thailand are fully justified to "go-it-alone" in their pursuit of their respective national interests[32]. Recognizing this reality of multi-speed integration among ASEAN members, ASEAN leaders implicitly endorsed the "2 plus X" approach, whereby any two member countries can choose to integrate certain sectors faster bilaterally if they so desire[33]. Nonetheless, there are valid concerns that this multi-speed approach taken towards integration will further stratify ASEAN and undermine its ability to act as a unified hub as it outreaches to the rest of the world.

[32] Apart from establishing FTAs with third countries, Singapore and Thailand have recently formed a "Singapore-Thailand Enhanced Economic Relationship" (STEER). Among other things, the aim of the STEER is to act as a high level forum to intensify bilateral economic cooperation across various sectors (Agriculture and Food, Life Sciences, Automotive Parts and Components and Financial Services). Other areas of cooperation include development of SMEs, customs cooperation, healthcare, spa services, tourism, transport logistics, financial services, ICT, and MRAs. In another substantive step in bilateral cooperation, Singapore has joined in the early harvest program initiated between Thailand and China in their bilateral FTA. The Agreement will involve the three countries eliminating tariffs on all fruits and vegetables. The Agreement will come into effect on 1 January 2005).

[33] The "plus X" presumably refers to either other ASEAN members or Diabgue partners like China and India.

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Annex 1
Rules of Origin in Selected Singapore's FTAs

Agreement between New Zealand and Singapore on a Closer Economic Partnership (ANZSCEP) A general Value Added rule is applicable to all products under the ANZSCEP. A product will qualify for preferential treatment if at least 40 percent of the ex – factory or works cost is of New Zealand or Singapore origin, and if the last place of manufacture is in New Zealand or Singapore. Manufacturers that source inputs from overseas can include the New Zealand or Singapore component of these inputs towards the 40 percent.
Agreement between Japan and Singapore for a New Age Economic Partnership (JSEPA) Each product has at least one corresponding specific rule of origin under the JSEPA. Under the JSEPA, a substantial transformation is deemed to have occurred if the CTC rule is met. The final product must have undergone a change in tariff heading (CTH; a different 4 – digit heading) from the materials used in its production. Additional flexibility is obtained for 264 products of interest to Singapore, with the provision of two alternative specific rules. Each of these 264 products will qualify for preferential tariff treatment if: i) it has undergone the requisite change in tariff heading; or ii) its Singapore content is at least 60 percent of the selling (FOB) price. Manufacturers that source inputs from overseas can include the Japan or Singapore component of these inputs towards the 60 percent.
European Free Trade Association – Singapore Free Trade Agreement (ESFTA) Each product has at least one corresponding specific rule of origin under the ESFTA. Like the JSEPA, a substantial transformation is deemed to have occurred under the ESFTA if the final product underwent a change in tariff heading (CTH; a different 4 – digit heading) from the materials used in its production. For some products, a Value Added rule is provided for in the ROO. Under this rule, products will qualify for preferential tariff treatment if their Singaporean content meets a specified percentage of the ex-works price. Manufacturers that source inputs from overseas can include the EFTA or Singapore component of these inputs towards the specified percentage. Depending on the product, the specified local content ranges from 40 percent to 80 percent ex-works price. For some chemicals / petrochemical products, a process definition is provided for in the ROO. Under this rule, products which undergo the specified manufacturing process or processes in Singapore will be considered Singapore origin.

<u>Singapore – Australia Free Trade Agreement (SAFTA)</u> All products need only fulfill a general rule of a specified threshold of local value content of either 30 percent or 50 percent. Generally, the ROO requires that the Singaporean content is at least 50 percent of the cost price. For selected products of importance to Singapore, listed in an Annex to the SAFTA, the threshold of content is lower, at 30 percent of the cost price. Singapore manufacturers that source inputs from overseas can include the Australian component of these inputs as part of the Singapore content.
<u>United States – Singapore Free Trade Agreement (USSFTA)</u> Each product has at least one corresponding specific rule of origin under the USSFTA. The ROO for certain products require that imported inputs used in the manufacture of the final product within Singapore are classified under a different tariff classification from the final product. For some electronic products, a Value Added rule of 30 – 60 percent must be satisfied. For certain chemicals / petrochemical products, a specified process must occur in Singapore, such as a specific chemical reaction.

Note: All the above FTAs recognize the concept of outward processing (OP), whereby all stages of production in Singapore are counted towards local content.

Source: Ministry of Trade and Industry, Singapore (http://www.mti.gov.sg/)