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Taking stock of Asean economic integration

The region must get its act together fast if it is not to lose out to other economic blocs

By RAMKISHEN S RAJAN

RECENT developments in the external environment have worked in tandem to raise the awareness of the need to hasten the process of intra-Asean economic integration.

These developments include:

- * (a) the stalling of multilateral trade talks;
- * (b) the economic emergence of China and India and concomitant concerns about the loss of Asean's global competitiveness; and
- * (c) the spate of new free trade agreements (FTAs) being negotiated in Asia.

While the overall economic effects of Asia's new wave of FTAs remain in some doubt, Asean is potentially well placed to reap the benefits of this new regionalism. The three largest countries in Asia - that is, 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, as has the United States. Nonetheless, for Asean to capitalise fully on its de facto hub status, greater efforts need to be expended to maintain cohesion and deepen intra-Asean economic integration.

But isn't Asean economic integration already at a fairly advanced stage? Under the region's flagship trade initiative - that is, the Asean Free Trade Area (Afta) - the bulk of intra-Asean trade enjoys tariff rates of between 0 and 5 per cent (the newer members - Cambodia, Laos, Myanmar and Vietnam - have been granted longer timetables to implement Afta).

While Afta came into force earlier than originally planned (Jan 1, 2002 for the original Asean members) and a target zero-tariff rate will be achieved by 2010 (2018 for the transition members), its impact has thus far proven to be rather disappointing for a number of reasons.

Many traders seem unaware of the tariff preferences available to Asean members, and even if they are aware, they have not availed themselves of these preferences. Why is this? On the one hand, the margins of preference between the Asean-wide tariff rate (referred to as the Common Effective Preferential Tariffs or CEPT) and those applied by Asean countries to imports from the rest of the world are rather low. On the other hand, there are concerns about excessive red tape and delays encountered when applying for the tariff preferences and uncertainty about Rules of Origin (ROOs).

In addition, Afta is narrowly focussed on reducing and eventually eliminating intra-Asean tariff barriers on merchandise trade. Non-tariff and other trade hindering barriers have not been addressed by Afta. The data makes apparent the limited effectiveness of Afta.

One, intra-Asean trade has accounted for only about one-fifth of Asean's total merchandise trade, this share having remained stagnant over the last decade (and much of the intra-Asean trade is due to Singapore). The share is far lower than other regional economic alliances such as the European Union (two-thirds) or the North American Free Trade Area (one half).

Two, only a small proportion of intra-Asean trade is actually conducted under the CEPT. In addition, little to no progress has been made in facilitating intra-Asean services trade (the Asean Framework on Services or AFAS has been largely ineffective).

Investor concerns

A recent McKinsey Consulting report on Asean Competitiveness highlighted three significant concerns that investors have expressed about the region:

- * (a) subscale and fragmented markets;
- * (b) unnecessary costs due to different product standards and customs procedures; and
- * (c) unpredictable policy implementation by Asean members, including the recent back-tracking by some countries on their respective liberalisation commitments (for example, Malaysia in the case of motor vehicles and parts, Indonesia in agricultural products, and the Philippines in the case of petrochemical products).

In recognition of these concerns, at the Bali summit in October 2003, the ten Asean leaders agreed to the goal of creating an Asean Economic Community (AEC) by 2020 (the so-called 'Bali Concord II').

The AEC, which was initially mooted by Singapore's Prime Minister Goh Chok Tong, is one pillar of the 'Asean Community', the other two being political and security cooperation and socio-cultural cooperation.

The primary objective of the AEC is to deepen and accelerate intra-regional economic integration by liberalising trade, investment and skilled labour flows and addressing behind-the-border barriers, thus creating a single production base and single market. This is clearly a worthwhile goal as, according to the McKinsey report, deeper integration could shave almost one-fifth off total costs of production in Asean.

As a follow-up to the McKinsey report, the Asean Economic Ministers established a High-Level Task Force (HLTF) on Asean economic integration. Specific initiatives suggested by the HLTF to advance the process of regional economic integration in the next few years include:

- * (a) the hastening of customs clearance and simplifying customs procedures;
- * (b) eliminating existing tariff and non-tariff barriers to trade;
- * (c) accelerating the implementation of the Mutual Recognition Arrangements (MRAs) for key sectors such as electrical, electronic and telecommunications equipment (trade in parts and components in these areas constitute 45 per cent of intra-Asean trade);
- * (d) harmonising standards and technical regulations;
- * (e) creating a more effective Asean Dispute Settlement Mechanism (DSM); and
- * (f) fast-tracking of liberalisation of eleven priority sectors. The sectors are automotive, wood-based products, rubber-based products, textiles/apparel, agro-based products, fisheries, electronics, air travel, tourism, Information and Communications Technologies (ICT), and healthcare.

Economic entity

While Asean needs to focus on making the region a seamless and enlarged production base, there remain a number of sceptics about the effectiveness of Asean as an economic entity (as opposed to a political one).

For instance, the vast and growing income gaps and heterogeneity among the various members may well act as a roadblock to deeper intra-Asean economic integration in the near term. These intra-regional disparities 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 liberalisers 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.

In addition to establishing FTAs with third countries, Singapore and Thailand have recently formed a Singapore-Thailand Enhanced Economic Relationship (STEER). Among other things, the aim of 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 small and medium-sized enterprises (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 programme initiated between Thailand and China in their bilateral FTA. The agreement will involve the three countries eliminating tariffs on all fruits and vegetables. It will come into effect on Jan 1, 2005.

Clearly, just as some Asean countries prefer to take a more graduated approach to liberalisation (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 pursuit of their respective national interests.

Recognising this reality of multi-speed integration among member countries, 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. (The 'plus X' presumably refers to either other Asean members or Full Dialogue partners like China and India).

Nonetheless, there are valid concerns that this multi-speed approach taken towards integration will further stratify Asean and undermine the association's ability to act as a unified hub as it reaches out to the rest of the world.

Indeed, Asean's first-mover advantage in the FTA game may in fact be eroding. For instance, China and India are both now much more focused on opportunities for mutual rather than zero-sum gains. There are signs of intensified business and economic interactions between these two Asian giants, as there are in bilateral cultural and political ties.

Asean's response to these and other dynamics in the global economy needs to be resolute; deeds and declarations will no longer suffice.

The author is a visiting fellow at the Institute of Policy Studies, Singapore and a senior lecturer in economics at the University of Adelaide, Australia