

# Chapter 10

## **ASEAN Economic Community: In Search of a Coherent External Policy**

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## Chapter 10

# **ASEAN Economic Community: In Search of a Coherent External Policy**

*Raymond Atje*

## **INTRODUCTION**

ASEAN is one of the most diverse regions in the world. It comprises ten countries with diverse economic development, culture, and social and political systems. Some of these countries may be regarded as still in the post-colonial stage; they have a strong sense of national identity and jealously guard their sovereignties. It may be argued that, because of such a background, ASEAN has opted for consensus-based decision-making, which is preserved in the recently adopted ASEAN Charter. Needless to say, the decision-making process in such a system tends to be very slow and the countries involved tend to adhere to the lowest common denominator in every decision to be made. In 2006 ASEAN as whole had a population of about 567 million, and a combined nominal GDP of US\$1066 billion.

ASEAN members presumably also differ in their endowments, tastes, and expectations. As a result, member states prefer different external policies as evident in, among other things, the increasing number of ASEAN member countries that have established or are in the process of establishing bilateral preferential trade arrangements (PTAs) with other countries. There is no reason to believe that they do not understand the consequence of their actions on other members, or that PTAs may create a noodle bowl syndrome in the region<sup>1</sup>.

Some governments in the region, most notably that of Singapore, view PTAs as building blocks toward global freer trade. One may, nevertheless, argue that, on the contrary, each time a country establishes a PTA with another country, the two countries will have less incentive to engage in multilateral trade negotiations. Moreover, as Dee (2005) argues, quite often concessions are made preferential under a PTA when in fact

it is better if they stay non-preferential. In addition, in general, PTAs do not promote comprehensive liberalization. Rather they tend to target only those provisions that explicitly discriminate against foreigners and leave restrictions that, from an economic point of view, should be removed, untouched by reform. For instance, regulatory restrictions on some sectors, such as power generation and distribution, clearly raise real economic costs, yet tend not to be targeted in PTAs because they tend to be difficult to liberalize. As such, the benefits from PTAs are likely to be smaller than if the countries in question pursue comprehensive unilateral liberalization instead.

Moreover, a study by de Dios (2007) shows that PTAs in the region tend to target only tariff barriers and neglect non-tariff measures (NTMs). Yet, NTMs are quite prevalent in the region. She cites two studies by Ando and Fujii (2004) and Ando (2005), which estimate the tariff equivalents of the NTMs in the ASEAN priority sectors and find substantial overall tariff equivalents in these sectors.

In Indonesia, tariff equivalents ranged between 27.5 percent for food products and 102.2 percent for live animals and products. Meanwhile, tariff equivalents for vegetable products and live animals in Malaysia are, respectively, 65.9 percent and 21 percent, whereas in Singapore the numbers are higher, i.e., 257.2 percent and 150.3 percent, respectively. Thailand registers the highest tariff equivalents of 596.6 percent for animal and vegetable oil, and 132.4 percent for food products (p.93). De dios also points that out of all the PTAs involving ASEAN as a group, only AFTA specifies a time frame for the elimination of NTMs. ASEAN-Korea FTA calls for identification of NTMs for immediate elimination but ASEAN-China FTA only states that NTMs should come under negotiations.

In view of the foregoing, the call for ASEAN member states to maintain ‘ASEAN Centrality’ in their external economic relations is appropriate. This call is stated in the newly adopted ASEAN Economic Community (AEC) Blueprint (hereafter referred to as Blueprint). It implies that member states should take into account ASEAN interests in the formulation of their external economic relations.

At the ASEAN Summit Meeting in Singapore in November 2007, the ASEAN Leaders adopted two important documents, i.e., the ASEAN Charter and the AEC Blueprint. AEC is one of the three pillars of the ASEAN Community to be established by 2020. The other two pillars are ASEAN Political and Security Community and

ASEAN Social and Cultural Community. The AEC is the ultimate goal of ASEAN's deliberate push toward greater regional economic integration, which was started in 1992 when AFTA was launched. There were two other initiatives introduced following AFTA, namely, AFAS in 1995 and AIA in 1998. The three initiatives form the basis for the AEC.

## **2. A REVIEW OF THE EXISTING ASEAN EXTERNAL POLICIES**

Before the creation of AFTA in 1992, ASEAN countries had already experienced rapid economic growth. Such growth was a result of unilateral economic liberalization, including unilateral tariff reductions, undertaken by these countries. In the 1970s and 1980s, countries in the region began to pursue unilateral economic liberalization. They liberalized their economies partly as attempt to attract foreign direct investment (FDI). During the same period, Japan, and later Korea and Taiwan, began to experience a hollowing out phenomenon. High wages in these countries prompted companies to relocate their production facilities to other countries in East and Southeast Asia, where wages were lower. These two factors complemented each other. The unilateral liberalization acted as a pull factor and the hollowing out phenomenon as push factor that led to significantly to large FDI flows into the region during the period under consideration. One unintended consequence of the process was an increased regional economic integration, a market-driven economic integration (Baldwin 2006).

AFTA was the first concrete attempt to create a formal regional economic integration. It dealt only with trade in goods and the plan was to allow preferential tariffs for trade between ASEAN members through the Common Effective Preferential Tariff (CEPT) scheme. Under the scheme, tariffs for most goods traded within ASEAN were lowered to 0 to 5 percent by January 2002. Notwithstanding the CEPT scheme, intra-ASEAN trade share has not grown significantly with the implementation of AFTA. The utilization rate of AFTA preferential tariff rates has been low. One reason for this, according to Baldwin (2006), is that AFTA's margins of preference on the high

trade-volume goods are too small to compensate for the administrative costs and delay of applying for the CEPT. Given that the margins of preference are thin, it is no surprise that AFTA was almost never used. With regard to advancing regional trade in services and stimulating cross border investment activities, ASEAN introduced two schemes i.e., AFAS and AIA.

Despite AFTA, ASEAN member states continued to pursue unilateral economic liberalization. In this case, they have been fairly consistent. Even the 1997/98 East Asian financial crisis did not seem to have a significant effect on this pursuit. None of the member states reversed their commitment to liberalization because of the crisis. As such, their liberalization programs were only partial when, arguably, they should be more comprehensive.

In addition, the member states also began to consider establishing preferential trade arrangements with other countries as a way to increase their external trade and, therefore, economic growth. Hence, toward the turn of the century, ASEAN countries' attitudes toward regionalism began to change. Some ASEAN countries that had not previously embraced preferential agreements began experimenting with FTAs. For instance, Singapore, perhaps the strongest proponent and practitioner of FTAs in ASEAN, already signed a number of FTAs with various countries such as the U.S. and Japan. The same is true for ASEAN as a whole. ASEAN has signed framework agreements on a number of preferential trade arrangements such as ASEAN-China Comprehensive Economic Cooperation, ASEAN-Korea Comprehensive Economic Partnership, ASEAN-Japan Comprehensive Economic Cooperation, ASEAN-India Comprehensive Economic Partnership, and AFTA-CER Closer Economic Partnership.

Notwithstanding, or perhaps more accurately, because of, unilateral liberalization, there has been a significant variation in member states' external policy. Sally and Sen's (2005) study of national trade policy in six ASEAN countries, i.e., Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam show that trade policies vary significantly from one country to another. Unilateral liberalization and domestic regulatory reform have transformed Singapore's economy to become one of the most liberal in the world, especially in trade. They have also helped reduce barriers in some service sectors. While Malaysia has a very high trade-to-GDP ratio, its trade policy is only relatively liberal. It has tariff peaks, tariff escalation, and non-tariff barriers in

politically sensitive sectors. In addition, protection in service sectors remains high. Thailand retains relatively high protection according to the standards of the ASEAN-6. Its average tariff is significantly higher; it has greater tariff dispersion, tariff escalation, and non-tariff barriers. Protection in service sectors is considerable.

Meanwhile, despite the recent economic crisis that had swept Indonesia, it retains a relatively liberal trade policy. While its average tariff is relatively low, it has tariff peaks and tariff escalations, especially in agriculture. The situation in the Philippines is quite similar to that of Indonesia. The average tariff is well below 10 percent but it has tariff peaks and tariff escalation, especially in agriculture. In addition, there is a sign of creeping protectionism, especially in agriculture, and has been backtracking on its AFTA commitments on petrochemical products. Finally, Vietnam as a new comer has undertaken significant steps to liberalize its economy. Trade liberalization has picked up since 2000 and tariff and non-tariff barriers have come down although its tariff structure indicates the existence of tariff peaks as well as high tariff dispersion. Protection in service sectors is very high.

Table 1 supports the above observation. Tariff peaks are common among the ASEAN-6 members with Singapore as an exception. Thailand and Malaysia have very high (simple) average MFN tariffs of 11.92 percent and 7.18 percent, respectively, in 2006. With regard to tariff-binding coverage, the Philippines and Singapore have the lowest percentages, i.e., 66.95 percent and 69.74 percent, respectively. Cambodia is the only ASEAN member that has tariff-binding coverage of 100 percent. Indonesia and Brunei have the highest tariff-binding coverage among the ASEAN-6 at 96.59 percent and 95.35 percent, respectively.

Sally and Sen also show the increasing tendency among the countries under consideration to pursue bilateral preferential trade arrangement with other countries. As noted above, Singapore is perhaps the strongest proponent of such a policy. But other members such as Thailand, Malaysia, and to a lesser extent Indonesia and the Philippines have also embarked on a similar path. A study by Chia and Soesastro (2007) corroborates this finding. It shows that in fact all ASEAN members are pursuing the same policy. As of October 2006, there were 139 FTAs involving ASEAN members (Table 2). This does not include de facto bilateral FTAs involving the ASEAN members<sup>2</sup>.

**Table 1: Average Tariff, Tariff Peaks and Tariff-Binding Coverage**

Country	Year	Duty Type	Simple Average	Weighted Average	Total Lines	Dom. Peaks*	Int. Peaks**	Coverage (%)
Brunei	2005	AHS	2.93	3.99	34,181	23.9	23.2	
Brunei	2005	BND	24.33	26.49	6,843	0.0	99.6	95.35
Brunei	2005	MFN	2.61	5.28	10,689	21.4	20.5	
Indonesia	2005	AHS	5.99	4.31	132,048	3.1	7.9	
Indonesia	2005	BND	37.14	33.71	8,027	0.4	96.9	96.59
Indonesia	2005	MFN	6.95	6.07	11,153	4.7	10.5	
Malaysia	2006	AHS	6.20	3.38	208,147	10.3	22.9	
Malaysia	2006	BND	14.54	6.79	8,684	0.6	50.8	84.25
Malaysia	2006	MFN	7.18	4.06	12,583	13.3	29.2	
Philippines	2005	AHS	5.40	3.22	117,098	3.9	4.8	
Philippines	2005	BND	25.65	11.40	4,366	0.0	81.6	66.95
Philippines	2005	MFN	6.26	3.75	11,091	5.7	7.9	
Singapore	2006	AHS	0.00	0.00	224,147	0.0	0.0	
Singapore	2006	BND	6.96	2.63	4,729	0.0	0.0	69.74
Singapore	2006	MFN	0.00	0.00	10,687	0.0	0.0	
Vietnam	2005	AHS	13.08	13.21	109,833	2.5	33.5	
Vietnam	2005	BND						0.00
Vietnam	2005	MFN	16.81	14.70	10,689	3.1	41.7	
Thailand	2006	AHS	10.82	4.61	85,159	4.7	22.8	
Thailand	2006	BND	25.70	15.96	4,631	1.1	60.7	75.02
Thailand	2006	MFN	11.92	5.35	5,504	6.2	26.4	

Note: \* denotes domestic (national) tariff peaks (the percentage of tariff lines that have bound tariff rates at least three times higher than the country's average tariff), and \*\* denotes international tariff peaks: the percentage of tariff lines that have bound tariff rates more than 15%. AHS (effectively average tariff), BND (bound tariff), and MFN (most favored nation).

Source: WITS.

**Table 2: FTA Status of ASEAN Countries (As of October 2006)**

Country	Proposed	Framework Agreement Signed/Under Negotiation	Under Negotiation	Concluded & Signed	Under Implementation	Total
Brunei	3	2	2	1	3	11
Coambodia	2	2	1	1	2	8
Indonesia	4	3	2	2	2	13
Lao PDR	2	2	1	1	4	10
Malaysia	5	3	5	2	3	18
Myanmar	2	3	1	1	2	9
Philippines	4	2	1	2	2	11
Singapore	5	2	8	2	11	28
Thailand	5	6	4	1	6	22
Vietnam	2	2	2	1	2	9

Source: Adapted from Chia and Soesastro (2007), Table 8.1.

Investment policy varies among the ASEAN member states. Policy concerning foreign investment has to take into account foreign investors' interests, such as the need

for protection, transparency of laws and regulations, etc., and host country's interests with its own economic and, perhaps, political objectives. Foreign investment policy in the region invariably has certain features (Hew et al. 2006). First, the relevance of domestic laws is evident, e.g., controls over entry as well as the utilization of foreign investment after entry. Second, many ASEAN countries use administrative agencies to screen the entry of foreign investment. Third, in general, there is a distinct preference for joint ventures between foreign establishments and local entrepreneurs. Fourth, some sectors are completely or partially excluded from foreign investment. Fifth, some countries offer incentives, particularly tax-related ones, to attract FDI into sectors regarded as important to the countries' economies. Sixth, performance requirement is widely used in ASEAN, e.g., to use a certain percentage of local labor, to use local inputs, etc. In addition, because of differences in the origin of their legal systems (common law vs. civil law), the definitions of investor, investment, and corporate nationality may vary across ASEAN member states.

In addition to investment policy, investment activities also depend on a host of behind-the-border issues such as competition policy (or the lack of it), protection of property, including intellectual property rights, corporate tax rate, the availability of efficient financial institution, etc. A study by Sudsawasd (2008) shows that various business regulations, such as procedures and time needed to start a business, cost of obtaining licenses, cost of firing workers, procedures and time needed to enforce contracts and declare bankruptcy have notable impacts on FDI inflows to the country in question. All of these factors inhibit FDI inflows.

### **3. CONFLICT OF INTERESTS AND EXTERNAL POLICIES IN ASEAN**

Three tentative conclusions may be drawn from the foregoing discussion. First, despite AFTA, ASEAN members continue to pursue unilateral liberalization. The pursuits, nevertheless, do not lead to a convergence in their external policies. Part of the reason, it seems, is that liberalization is only partial. For one reason or another, they

continue to protect certain sectors of their economies either through prohibitive tariffs, non-tariff barriers or outright exclusion. This is not to say they should stop liberalizing their economies. On the contrary, they should be encouraged to go even further and pursue a more comprehensive, rather than partial, liberalization policy. Arguably, as these economies become more liberal, their perspectives about various aspects of external policy will converge.

Second, more members are likely to actively establish bilateral FTAs with other countries. This too will create problems. In addition to the usual noodle bowl syndrome, a bilateral FTA is, by its nature, an exclusive arrangement. Since FTAs tend to target only provisions that discriminate against foreigners, their coverage tends to be partial rather than comprehensive. As the number of FTAs in the region increases, the members' views on their role in the development of regionalism in the region will become increasingly compartmentalized as well. In the end, these views will tend to deviate further and further away from one another and will undoubtedly be reflected in their external policy.

Third, investment policy deals primarily with domestic issues pertaining to national treatment, competition policy, protection of property, including intellectual property rights, the availability of efficient financial institution, etc., but laws and regulations pertaining to these issues are likely to vary significantly among the ASEAN members. This will certainly affect their foreign investment policy.

While the Blueprint's call for ASEAN members to maintain ASEAN centrality in their external policy may be appropriate, it remains to be seen if it is attainable. In light of the foregoing, it may be argued that the call constitutes a difficult proposition to put into practice. Much of the discussion that follows explains the reason and explores ways to mitigate the difficulty. But first, one needs to explain the meaning of 'ASEAN centrality'. One way to interpret the concept is by emphasizing that each ASEAN member should take into account ASEAN interests each time it issues a new external policy. This implies that it should also take into account the other members' interests since it is not in the interest of ASEAN to see some of its members suffer because of the action of one of its members. Otherwise, it defeats the purpose of establishing ASEAN in the first place. In other words, each member should ensure that none of the other members will be worse off because of its policy. Herein lies the difficulty.

Two problems arise. First, there is no reason to believe that members will voluntarily heed the call unless they see advantages in doing so. Otherwise, they have very little, if any, incentive to do so. Second, ASEAN as an institution has no mechanism to enforce it. Moreover, the call itself is too vague to be enforceable. The most that ASEAN can do is to ask for non-binding commitment from its members.

Attaining a coherent external policy will not be a problem if ASEAN members have the same objective function. In such a case, ASEAN can act as a benevolent authority to devise a common external policy to be implemented by all members. But as earlier noted, ASEAN members have different endowments and, presumably, tastes. It is also fair to assume that they have different expectations about the outcomes of a certain external policy. Given this ex-ante heterogeneity, each of them will try to optimize its expected gains from the policy in question. Inevitably, they will try to maximize different objective functions.

Take ASEAN-China Comprehensive Economic Cooperation (or ASEAN-China FTA) as an example. Immediately after the agreement for its establishment was signed, Thailand started to negotiate a separate bilateral PTA with China. This indicates that what the members agreed upon in ASEAN-China was simply the lowest common denominator. Thailand clearly believed that it could get a better deal than what it got under ASEAN-China FTA. But even without a separate bilateral PTA, the ASEAN-China FTA already constitutes ten de facto bilateral PTAs. The reason is each of the ASEAN members has its own exclusion or inclusion list, i.e., a list of goods to be excluded from the early harvest program, or list of goods to be included in the early harvest program. The question is why?

Trade often means reallocation of resources from the sectors where the country does not have comparative advantage to the sectors where it has comparative advantage. By implication, trade activities may not be Pareto efficient, at least not in the short run. Some sectors gain at the expense of others. Also, even if there is an obvious aggregate gain, the political cost is perhaps too high for the authority to bear. Hence the protected sectors as manifested in tariff peaks and exclusion list. This could have been avoided had ASEAN had a mechanism to share the combined gains, the cost and perhaps the risk associated with the ASEAN-China FTA. Needless to say, even if it has such a mechanism, the members might still have different perspectives on their distribution.

Meanwhile, five ASEAN members have signed bilateral economic partnership agreements (EPAs) with Japan, namely, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. A study by Hiratsuka *et al* (2008) shows how these members settled on different rules of origin (ROO) formula. Singapore agreed to use change in tariff classification (CTC) rule, whereas Malaysia agreed to a choice of CTC or 60 percent value content (VC) and Thailand to a choice of CTC or 40 percent VC. Alas, members that fare badly under those agreements cannot take advantage of related concessions given to ASEAN in ASEAN-Japan Comprehensive Economic Partnership (CEP) agreement. A careful reading of the ASEAN-Japan Framework for CEP suggests that concessions given under bilateral EPA cannot be renegotiated in the negotiation of ASEAN-Japan CEP. That is, even if the ASEAN manages to get better concessions from Japan than those accorded to its members under bilateral agreements, the members in question are not entitled to those concessions.

It should also be noted that even ASEAN has not been very consistent in this regard. AFTA and ASEAN-China FTA use a 40 percent VC rule, while ASEAN-Korea FTA uses 45 percent VC rule.

#### **4. SEARCHING FOR COMMON GROUND AND POLICY OPTIONS**

The discussion in the previous section rests on the assumptions well known among economists: individual rationality and greed. But there may be limits to this approach, especially when applied to relations between states. First, the reciprocity principle (i.e., to respond to recognition or action of one state in with similar recognition or action) is common in states' relation. States also use the reciprocity principle when trying to preserve beneficial long-term relationships or to establish reputation as a reliable partner. Second, repeated interactions among states may lead convergence given their expectations of the future outcomes of their collective endeavor.

ASEAN's own experience is instructive in this case. The decision to form AFTA came only after many false starts. After the first summit meeting in 1976 in Bali,

ASEAN began experimenting with several cooperation programs such as the ASEAN Industrial Projects (AIP), the ASEAN Preferential Trading Arrangement (PTA), ASEAN Industrial Joint Venture (AIJV), and ASEAN Industrial Cooperation (AICO). The programs, however, mainly ended up in failure partly because the member countries were not prepared to share their markets (Chia *et al.*, 2007).

That attitude began to change with the introduction of AFTA. Tariff reduction under AFTA has been quite progressive, having moved from the original timeframe of reducing tariffs to the 0-5 percent range in 15 years (beginning in 1993) to 1 January 2002. The zero-tariff target is to be achieved by 2010 for ASEAN-6 and 2015 for CLMV. Recognizing the development gaps between its member countries, nearly all liberalization commitments in ASEAN face two separate timelines: one for the ASEAN 6 and a later date for the CLMV countries. For ASEAN-6, by January 2005, 99 percent of all products in the CEPT Inclusion List had their tariffs reduced to the 0 to 5 percent target while 64.2 percent had achieved zero tariffs. In addition, all CEPT products had been transferred to the Inclusion List, and the average tariff brought was down to 1.87 percent compared to 12.76 percent in 1993. For CLMV, 87.2 percent of the products had been moved to the CEPT Inclusion List and tariffs on 71.05 percent had been brought down to the 0 to 5 percent level (Chia and Soesastro. 2007).

Now ASEAN members are trying to deepen and widen further the regional economic integration by agreeing to establish the AEC. Under the AEC, 12 priority sectors have been identified for accelerated integration, covering about 4,000 tariff lines or 40 percent of the total tariff lines in ASEAN. These priority sectors are subject to an earlier deadline than AFTA. These are agro-based products, air travel, automobile products, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparel, tourism, wood-based products, and logistics. Under this scheme, tariffs will be eliminated on 85 percent of the products in the priority sectors by 2007 for ASEAN-6 and 2012 for CLMV.

There are a number of interesting observations concerning the ASEAN experience. First, there had been a long learning curve between the inception of the organization and the establishment of AFTA. Prior to 1976, ASEAN did not produce any important economic cooperation initiative, but only began experimenting with a number of economic cooperation programs after that year. The learning process continued even

after the establishment of AFTA. Second, the pace and intensity of economic cooperation among the members seem to accelerate over the years. One possible explanation for this is that repeated interactions help foster mutual trust among the members. This, in turn, provides an impetus for further cooperation. Third, as they were intensifying their economic cooperation, the members also continued to pursue unilateral economic liberalization. It may be argued that the unilateral liberalization agenda helped make possible the cooperation efforts that led to an agreement on CEPT. They saw similar long-term benefits from these two approaches to liberalization.

The AEC Blueprint mandates ASEAN to work toward achieving a coherent approach to ASEAN's external economic relations, including its negotiations for free trade and comprehensive economic partnership agreements. As stated earlier, the main obstacle is the fact ASEAN members do not have the same objective function. One way to go around this problem is for ASEAN to clearly indicate the viable external policy options that can be pursued by members. Members should see the long-term benefits of these options.

Following are a number of possible options, which are not necessarily mutually exclusive in their implementation. First, ASEAN is to multilateralize the CEPT. This is not a new idea, since it is already cited in the AIA scheme. Under the AIA, ASEAN members are committed to a gradual elimination of investment barriers, liberalize investment rules and policies, and grant national treatment to ASEAN investors by 2010 and to all other investors by 2020. ASEAN can do the same for the CEPT by gradually extending preferential treatments among the members to other countries. To achieve this objective, ASEAN members should develop a common strategy to reduce their MFN tariffs, eliminate peak tariffs and lower the bound tariffs. The aim is to gradually bring MFN tariffs down to zero, say, five years after the CEPT. To prevent the reversal of the decision, the bound tariffs should be lowered as well. The timeline should be consistent with that of the AEC. Hence, there should be two separate timelines for ASEAN-6 and CLMV. In short, ASEAN should start aiming at pursuing a truly open regionalism. Essentially, by multilateralizing the CEPT, ASEAN will be establishing a *de facto* customs union.

Table 3 shows that the above is attainable. First, the average MFN tariffs for ASEAN-6 and CLMV are relatively low, even with peak tariffs. The same is true for the

standard deviation of tariffs, which is small relative to the average tariff. Without peak tariffs, the average tariff will become even smaller. At the same time, the discrepancy between standard deviation and average tariff will also become narrower. Based on this observation and the previous discussion, it may be argued that the attempt to bring down MFN tariffs to zero is doable. What is needed is for ASEAN members to have a guideline that provides a clear direction on how to achieve the objective and implementation timeline. The guideline should be executable as well measurable.

**Table 3: ASEAN average tariff, standard deviation, maximum and minimum rate**

Region	Year	Duty Type	Simple Average	Weighted Average	Standard Deviation	Minimum Rate	Maximum Rate
ASEAN-6	Latest Available	AHS	5.46	2.43	10.60	0.00	170.00
ASEAN-6	Latest Available	BND	23.04	11.19	14.82	0.00	226.00
ASEAN-6	Latest Available	MFN	5.81	2.96	11.48	0.00	170.00
CLMV	Latest Available	AHS	11.28	12.22	16.31	0.00	150.00
CLMV	Latest Available	BND	28.27	32.23	41.29	0.00	550.00
CLMV	Latest Available	MFN	11.60	13.67	14.64	0.00	150.00
ASEAN	Latest Available	AHS	6.47	3.01	12.32	0.00	170.00
ASEAN	Latest Available	BND	24.09	11.33	22.77	0.00	550.00
ASEAN	Latest Available	MFN	8.13	3.60	13.17	0.00	170.00

*Note:* AHS (effectively average tariff), BND (bound tariff), and MFN (most favored nation).

*Source:* WITS.

To facilitate trade in services, ASEAN members should strengthen their regulatory environment and institutional capacity, improve transparency and predictability of domestic regulation, and use international standards to achieve harmonization. At the same time, ASEAN should start multilateralizing its liberalization of trade in services, i.e., by opting for global opening rather than regional opening. Meanwhile, in negotiating trade liberalization commitments, ASEAN members should shift from being on a ‘positive list’ to a ‘negative list’.

Meanwhile, in dealing with investment, ASEAN members should be encouraged to adopt national treatment in their domestic laws. Alternatively, the AIA should immediately accord national treatment to all investors and apply non-discrimination in the opening up of industries to foreign investment. As mentioned earlier, investment policy mainly deals with behind-the-border issues. ASEAN members must harmonize

these laws and regulations. By doing so, the members will be compelled to adopt investment policies that are increasingly favorable to one another.

In light of the above, it may be argued that ASEAN members should harmonize their laws and regulations that are relevant to external policy, i.e., laws and regulation that policymakers will consider or refer to when formulating external policies. Of course, the harmonization should be toward more liberal laws. There is no point of harmonizing the laws toward less liberal ones. In other words, it should be made clear at the outset that the aim of the harmonization is not for the sake of harmonization but for the sake of arriving at a more liberal regulatory environment.

With regard to standards, ASEAN members need to harmonize all their industrial standards. Whenever possible, ASEAN should aim at adopting widely acceptable international standards. This would enable ASEAN companies to compete in the world market as well as within ASEAN itself. A piecewise approach to the adoption of standards is costly and should, as much as possible, be avoided. However, care should be taken to ensure that a higher standard does not constitute a de facto barrier to entry and hence less choices for consumers.

Finally, ASEAN should establish a regional mechanism for closer consultation and coordination among the members. Consultations should not be limited only among government officials but should also include relevant stakeholders, with a view to facilitating the process of arriving at regional negotiating positions in ASEAN's free trade and comprehensive economic partnership negotiations with dialogue partners. In addition, ASEAN should consider developing templates to be used as guidelines by ASEAN negotiators in the negotiating trade, investment, and FTA agreements. ASEAN members should also alert each other when planning to enter negotiations to establish preferential trade arrangements with other countries. ASEAN should provide a set of guiding principles that would be used by ASEAN members in their negotiations. Such a guideline should not be as rigid as a template. There should also be a mechanism for closer consultation and coordination among the members in dealing with FTA negotiations with non-member countries.

## 5. CONCLUSION

When ASEAN members decided to establish the AEC, the organization had gone through a long learning process. It took almost ten years before ASEAN started experimenting with a number of economic cooperation programs. Most of them ended up in failure but not necessarily in vain. They were part of the learning process. Arguably, it was the accumulated knowledge from the process that led to an ambitious decision to establish AFTA in 1992. AFTA was the first serious attempt to establish regionalism in East Asia.

From this point of view, AFTA itself may be regarded as part of the learning process, which eventually led to an even more ambitious program, namely AEC. One component of the AEC is for the members to have coherent external policies. Various studies suggest that ASEAN members do not have the same point of view concerning external affairs and how to approach them. This is reflected in the members' external policies concerning trade, FTA, and investment. They vary across member states. Making these polices coherent will not be easy.

However, if ASEAN's experience is any indication, it may not be impossible at all. To succeed, members ought to see the merits of having coherent external policies in ASEAN. Alternatively, they should understand the cost of having incoherent trade policies among member states that are trying to create a single market, or the dire consequences to ASEAN exporters of members having different rules of origin in the various FTAs. In addition, the member states should be able to see merits of all the proposed options to achieve coherent external policies in the region. Only then will they be willing to voluntarily pursue those options.

It is important to stress the need for voluntary participation of the member states because the existing decision-making mechanism in ASEAN, which is based on consensus and ten minus X formula, implicitly rules out the possibility of imposing a certain rule on the members without their prior consent.

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## **NOTES**

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1. Trade diversion is one possible adverse effect of a preferential trade arrangement. Since each of the parties to the arrangement offers preferential treatment to goods imported from the others, the arrangement is likely to increase the trade volumes between each other. Unfortunately, the gains may be at the expense of other countries' trade with each of them.
2. For further discussion on de facto FTAs within ASEAN, see Baldwin (2006).