

EXECUTIVE SUMMARY

ASEAN economies as a group have signed free trade agreements with China, Japan, Korea, India and Australia/New Zealand. There is now an interest in forming a larger regional agreement, for a couple of reasons. The first is that the gains from integration are greater across wider areas with deeper coverage – there is also an interest in deepening the commitments to integration. The second reason is that there is a concern that the proliferation of trade agreements adds to the costs of decision-making in international business. The goal is therefore to achieve wider and deeper integration with lower costs to business. The ultimate goal is to operate economies more efficiently and achieve higher growth but the immediate task is to attain a higher level of integration.

A new wider economic agreement could be constructed in a new set of negotiations, but the track that is preferred by ASEAN is to build up from the ‘+1’ agreements into a new ‘ASEAN++’ structure. There are advantages in this approach given the degree of common membership of the agreements under consideration. There is also a significant risk that any attempt to adopt a top-down approach based on a new region-wide agreement could add yet another agreement to the existing ‘noodle bowl’ and possibly one which is less liberal, given the difficulty of reaching agreement across the larger number of participants. This outcome will not contribute to the goals of wider and deeper integration with lower costs to business. However, the bottom-up process is not without these risks either, and a set of principles is important to manage those risks. These risks might not be avoided completely but at least they can be given attention and efforts made to reduce them.

The focus in this project is on the principles that might be applied in this circumstance and for these purposes. The decision was made to concentrate on trade facilitation, rules of origin, services and investment.

The approach adopted in this work was to pay great attention to the design and operation of production supply chains in the East Asian region. When deriving relevant principles for the consolidation of agreements, these features of the way that business actually works could then be taken into account, with the expectation of producing richer insights for the goals of designing a low risk path to wider and deeper integration and to lower costs of doing business.

The work began with a review of the treatment of the various dimensions of the existing agreements. It was generally found that:

- considerable impediments to trade and investment remain at economy level;
- there is not a high degree of consistency within agreements, since commitments by economy vary considerably;
- commitments can vary across agreements for the same economy; and
- commitments made in these agreements appear to be less liberal than actual policy.

This situation suggests that, despite its advantages, there are challenges in the application of the bottom-up approach. It also means that progress on the different components of a consolidated ASEAN++ approach referring to goods, services, investment and trade facilitation may have different requirements. In meeting those requirements the elements could move at different rates so the whole project might proceed with a series of building blocks. With this perspective, the suggestions from this project are the following five steps:

1. put immediate priority on areas such as trade facilitation where there are ‘gains all round’ from reform;
2. send a strong signal about the commitment to integration by removing rules of origin in goods at the lower tariff rates – otherwise simplify them and then adopt a liberal benchmark or reference rule (for goods, services and investment) before moving to consolidate existing agreements;
3. work to remove gaps between actual policies and those committed in goods, services and investment in the agreements and continue to work to reduce most favored nation (MFN) tariffs on goods;
4. start work on services and investment by designing and applying commitments in services and investment in areas which are of great value to supply chain operations; and
5. support the work on services by a capacity-building program on domestic regulation.

According to the supply chain perspective, there is a clear priority for work on trade facilitation. An agreement involving ASEAN and the ‘+1 partners’ which incorporates a set of key principles of trade facilitation would be valuable. So far lacking in work on trade facilitation is a commitment to timelines and monitoring implementation. It would also be desirable for a system of monitoring progress to implementation to be designed. Complementary actions are work on capacity building to support implementation, and continuing reference to linkages to other regional (APEC – Asia-Pacific Economic Cooperation) and global (WTO – World Trade Organization) processes. There are two important features in this arrangement – it would be:

- applied to all trading partners, not just the ASEAN+6 members; and
- the foundation of an ASEAN++ arrangement but its implementation is not tied to progress on other areas.

With respect to goods, the first step is to establish the context in which agreements operate. The best approach to the operation of free trade agreements and to the efforts to reduce their costs, is to continue to work to reduce MFN tariffs and therefore to remove the incentive to operate under the more complex conditions of the agreements. ASEAN++ participants would be expected to demonstrate their commitment to MFN reform. One demonstration of that commitment would be to at least make binding commitments in the WTO on tariffs at the current rates of their application.

The next priority is to come to an understanding on an approach to rules of origin in the ASEAN++ framework. Not all sectors nor all firms face major issues with the application of rules of origin, but in some areas, particularly for small firms, they remain a constraint. Greater participation in trade by small firms can yield significant benefits in terms of productivity growth. Work to simplify rules of origin would assist their participation and could proceed in a series of steps.

A first step is to drop all rules of origin for low tariff items, which has the effect of multilateralism the tariff cuts in that range. These changes are expected to be concentrated in trade in intermediate products which is critical for supply chain operations. Remaining tariffs where the rules of origin continue to be relevant are more likely to be finished goods.

Another suggestion with respect to rules of origin is that ASEAN and all +1 partners adopt a benchmark to be applied in any new ASEAN++ framework. The argument for a benchmark is based on the observation that there is a risk that more

restrictive rules will be adopted in agreements with wider membership. The benchmark is used to provide a cap on the degree of restrictiveness of the rules in any new agreement in order to manage this risk.

The choice of the benchmark is a matter for negotiation: it could be a change of tariff classification or a content rule, or a choice of both (but it should not involve any combination of individual rules). A rule on the regional value of content is common in the set of agreements examined in this project but the rule on a change in tariff classification is sometimes easier to meet, although that depends on the production process involved.

The negotiated benchmark should be ambitious and also be made more liberal over time: a schedule for this relaxation should be agreed at the foundation of the new structure. Rules are then selected and transferred from existing agreements at the tariff line level but with a view to moving closer to the lower level of restrictiveness set by the benchmark. This approach does not involve harmonization, for the reason that such an approach risks movement to less liberal rules of origin.

This benchmark would be negotiated by ASEAN and all the +1 partners. It is an important principle that all the +1 partners are involved in this constitutional stage, even if their particular +1 agreement is not included in the foundation stage of work on an ASEAN++ agreement. All +1 partners could also be invited to continue to monitor implementation, and the private sector would also be involved.

The bottom-up approach could precede when parties to an existing pair (or more) of +1 agreements decide to consolidate them. A decision would also have to be made of whether to leave the existing +1 agreement(s) in place. The new agreement would have a wider area of coverage but could have different rules of origin. As an additional

contribution to helping to manage the risk of more restrictive rules in the wider agreement, the original +1 agreements could be left in place as a choice for traders for a fixed period of time. However, doing so would add to the costs of doing business and would imply that the benchmark rule of origin was not sufficiently ambitious. The existing agreements should therefore be removed once the consolidated agreement is in place. Failure to do so would diminish the value of the ASEAN++ process.

It is not only the rules that matter but the manner of their implementation. This is also a focus in the work on trade facilitation. More specifically, in terms of processing time and for the purpose of meeting a common rule of origin, it is useful to establish a system of mutual recognition of the certificates of origin and mechanisms for reaching common understanding of the correct tariff classification codes for particular products.

Investment must be included in the coverage of a new agreement, given its role in the construction of the supply chains. With respect to investment, recommendations are to document actual policy in any new consolidated agreement, which avoids backsliding on that policy at least with these trading partners. To be added then would be a commitment to further liberalization, with schedules for reform in key sectors (similar to those used in the GATS – General Agreement on Trade in Services).

The question remains as to whether investment policy is easily applied in a discriminatory manner. It may not be easy to do so and the benefits of commitments may be available to all investors. But in any case ASEAN can show leadership by offering to take in new members to a regional investment agreement if those who are new abide by the same principle of removing gaps or ‘water’ between actual investment policy and committed policy.

There is a high degree of complementarity between services and investment commitments. Investment is important directly as a mode of delivery of many services. Furthermore, international investment is more likely to be attracted by the efficient provision of services, such as logistics, which is particularly important in relation to supply chains.

With respect to services, the recommendations for the long term are similar to those for investment, that is, removing any ‘water’ in commitments and continuing to liberalize. It will be important to commit to and continue to refer to the goals of integration. However experience in the WTO, and work here on the extent of commitments in the +1 agreements, suggests rapid progress on services commitments will be difficult.

A first step for progress on services is therefore not to move immediately to a new consolidated agreement but to work on the environment in which that agreement might be built. This means a focus on capacity building in services that deals with the key issues in the design of domestic regulatory systems. Considerable work of this type is already in progress in APEC – an important principle for ASEAN and its +1 partners as they seek to consolidate their agreements would be to confirm their commitments to APEC work programmes with specific time lines.

Meanwhile, commitments could be made on a group of sectors which are especially important to the operation of regional supply chains. These commitments would be informed by and complement the Master Plan on ASEAN Connectivity.¹

¹ Master Plan on ASEAN Connectivity, Jakarta: ASEAN Secretariat, January 2011¹

Both services and investment arrangements would also have to confront the question of rules of origin, but generally these are less of an issue compared to the commitments themselves and can be made relatively liberal (e.g. based on commercial presence).