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## Die politische Ökonomie der ASEAN-Wirtschaftsintegration und bilaterale Freihandelsabkommen

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## Studie

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### **Die politische Ökonomie der ASEAN-Wirtschaftsintegration und bilaterale Freihandelsabkommen**

Christopher M. Dent

#### **Abstract**

Der Zusammenhang zwischen ökonomischem Regionalismus und bilateralen Handelsabkommen hat in den letzten Jahren an Bedeutung für die wirtschaftliche Entwicklung Südostasiens gewonnen. Regionale Integrationsprozesse auf der Makro-Ebene umfassen die ASEAN-Freizone AFTA, die Initiative für eine ASEAN-Integration (IAI) und die ASEAN-Wirtschaftsgemeinschaft (AEC). Dies wurde auf der Mikro-Ebene durch eine Regionalisierung (beispielsweise von Produktionsnetzwerken) und auf der Meso-Ebene durch subregionale Projekte wie Wachstumsdreiecke untermauert. Singapur und Thailand sind Wegbereiter bei der Unterzeichnung von bilateralen Abkommen mit unterschiedlichen Partnern. Es wird die These vertreten, dass Freihandelsbilateralismus bestimmte Schwierigkeiten bei der Gemeinschaftsbildung in Südostasien mit sich bringt. Anders als gesamtregionale Projekte wie AFTA oder IAI bauen sie nicht auf den Prinzipien der Inklusion und der Gleichheit der Interessen auf. Während wirtschaftliche Integration Realität ist, bergen bilaterale Freihandelsabkommen die Gefahr, dass sie die Entwicklungsunterschiede in der Region verbreitern und das Spannungspotenzial innerhalb der ASEAN vergrößern (Manuskript eingereicht am 10.10.2006; zur Veröffentlichung angenommen am 20.12.2006)

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## 1 Introduction

Southeast Asia is at a critical juncture concerning the development of its regional economic integration and matters pertaining to regional community-building generally. Various levels and manifestations of integration have transpired between the region's constituent parts over recent years. At the micro-level, business-driven regionalization processes (e.g. the development of regional production networks) have fostered closer economic interdependent linkages between Southeast Asian countries. This has provided an important foundation on which meso-level (i.e. between business and government) integration initiatives have been built, these being sub-regional projects such as 'growth polygons' and partial scope trade agreements between sub-sets of countries within the region.

Finally, there are a number of Association of Southeast Asian Nations (ASEAN) macro-level projects at the apex of the region's integrational agenda: the ASEAN Free Trade Area (AFTA), Initiative for ASEAN Integration (IAI) and the ASEAN Economic Community (AEC). All these developments are intra-regional focused, arising within the region, yet Southeast Asia is also being drawn increasingly into various extra-regional integration projects. These include broader regional frameworks like ASEAN Plus Three and the East Asia Summit groupings that have to date primarily centered in improving regional financial governance in the aftermath of the 1997/98 financial crisis. In addition, ASEAN member states – especially Singapore and Thailand – have developed bilateral FTA links with a number of trade partners outside Southeast Asia (Japan, United States, India, and various Pacific American states), as well as ASEAN-level FTA links with China and South Korea. This paper argues that of all these inter-related integrational processes the relationship between the FTA bilateralism and Southeast Asia's efforts at regional community-building is the most problematic. It first examines various levels of Southeast Asia's economic integration processes, as categorized above, and then explores the international political economy of FTAs and ASEAN. Therein, we consider the nature of the bilateralism – regionalism relationship in Southeast Asia and will argue that bilateral FTAs work against objectives of regional community-building.

## 2 Economic Integrational Developments in Southeast Asia

### 2.1 Historic and Contemporary Contexts

Southeast Asia has a long history of international economic integration. For

centuries, the region's trading communities had facilitated commerce between China and the Indian sub-continent along the Straits of Malacca and other sea-routes. Colonization by the Western powers then broadened the commercial network into global-scale imperial trading systems. Most recently, foreign multinational enterprises (MNEs) have forged new integrational links through the development of regional production networks, whereby workforces and organizations from different Southeast Asian countries are incorporated into transnational divisions of labor. Added to this are various integrational initiatives occurring through ASEAN, Southeast Asia's prime regional organization that has increasingly focused on regional economic affairs in the post-Cold War era.

## 2.2 Micro-Level Developments: Regionalization in Southeast Asia

Intra-regional trade in Southeast Asia accounts for around 20 percent of ASEAN countries' total trade. This may not appear that high a figure but a large share of this derives from the regional production network (RPN) trade of MNEs. Unlike Northeast Asia, Southeast Asia has a long history of "hosting" foreign capital. After the colonial period, the next wave of inward foreign direct investment (FDI) came from Japanese companies during the mid-1980s to early 1990s. The 1985 Plaza Accord was the main catalyst for this, whereby Japan agreed to appreciate the value of the yen in order to reduce its trade surpluses with the United States and European Community. Seeking a more competitive production base for its manufacturing exports, Japanese companies relocated operations from Japan to Southeast Asia, especially in labor-intensive industry activities such as textiles, basic electronics and other lower-tech manufacturing. This helped pave the way for other MNEs, mostly from the U.S. and Europe, to also increase their investments in the region during the 1990s.

Improvements in infrastructural technologies and the techno-industrial capacity of Southeast Asian nations led to the development of more complex and region-wide divisions of labor across an increasingly broad range of industry sectors (Henderson *et al* 2002, Kimura *et al* 2004, Yun 2003). The development of regional production networks was based on three fundamental determinants. First, MNEs could more easily search for the most cost-effective means of producing whole or component elements of products as more nations competed with each other for production contracts. Second, MNEs look to identify the competitive advantages of nations in the qualitative terms of specialist production capabilities that other nations do not possess, e.g. auto-part production in

Thailand. This is an organizing principle of RPNs and also closely relates to the industrial district phenomenon in which nations develop dense supplier network clusters that are geographically concentrated to serve and attract major assembly firms. Regional production networks may be anchored in such locations with international links to other nodes in the production chain. Third, the production chain activities within an RPN may be dispersed in such a way that helps a multinational firm spread corporate risk. Different production facilities within the RPN may be devised to easily duplicate the work of other network nodes, which is advantageous when disturbances (e.g. sudden inflated costs or a political crisis) occur within one or more countries involved in the production network.

Although it is China that now attracts the largest inflows of manufacturing FDI into the wider East Asia region, regional production networks still constitute an important binding force between ASEAN economies and have contributed significantly to the general development of regionalization in Southeast Asia overall. Moreover, this has provided an important micro-level foundation to regional community-building through inter-agent socialization, business-to-business learning, economic interdependence and other coalescent effects. Drawing upon the seminal work of Hurrell on regional studies, we may define the *regional community-building process* as one whereby a region develops “into an active subject with a distinct identity, institutionalised or informal actor capability, legitimacy and structure of decision-making in relation with a more or less responsive regional civil society, transcending old state borders” (Hurrell 1995:466). Notwithstanding ASEAN’s traditionally very low-key institutional approach to fostering regionalism, this definition of regional community-building has become an increasing approximation to ASEAN’s integrational ambitions.

### 2.3 Meso-Level Developments: Sub-Regional Projects in Southeast Asia

In between micro-level regionalization (i.e. business-led integration) and macro-level regionalism (i.e. state-led integration projects) are various meso-level initiatives within Southeast Asia that are sub-regional in geographic formation. These build on existing localized RPN foundations and other manifestations of (sub-) regionalization, such as cross-border trade, and are combined with international policy frameworks between sets of Southeast Asian countries designed to further cultivate the above.

### 2.3.1 First Phase Sub-Regionalism

This concerns the emergence of various “growth triangle” or “growth polygon” projects during the late 1980s and early to mid 1990s, and typically incorporates contiguous border areas from different nation-states participating in a symbiotic development relationship. These sub-regional economic zones (SREZs) as we shall collectively refer to them are founded on the exploitation of economic complementarities between participating territories. The role of each territory depends upon its comparative level of development, access to factor resources, position in regional or global production networks and so on. Geographical proximity remains a key advantage in operating sub-regionalized networks as flexible production systems particularly depend on a locality of suppliers that have the capacity for “just-in-time” logistics. In this respect a key role for governments (both local and national) is the development of infrastructural linkages, which may be viewed as supportive public good investments designed to help facilitate trans-border exchanges within the SREZ. This may therefore involve the construction of new transport links, energy generation provision and communication hubs and networks. Governments may also relax rules on international commercial practices and factor mobility between participating territories. Growth triangles and polygons are particularly prevalent in Southeast Asia, and below are listed the region’s main SREZ projects:

- *Indonesia-Malaysia-Singapore Growth Triangle (IMSGT)*: founded in 1989, linking Singapore to Indonesia’s Riau province and Malaysia’s Johor province.
- *Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA)*: established in 1992 and involving Eastern Malaysia, Brunei, Sulawesi, Kalimantan, the Moluccas, West Papua and Mindanao.
- *Indonesia-Malaysia-Thailand Growth Triangle (IMTGT)*: centered on the Straits of Malacca, an historic trading route, and established in 1993.

Taking the second of these as an illustration, the primary aims of the BIMP-EAGA were to boost trade, tourism and investment in the sub-region based on existing transborder business linkages and developing policy co-operation between member governments to further facilitate international business expansion within the SREZ. Extra-regional “development partners” included the Northern Territory of Australia, China, Japan, Asian Development Bank, and the German Technical Cooperation Agency. However, progress in coalescing and developing BIMP-EAGA economic activity has been relatively slow, mainly owing to the lack

of infrastructural investment. A similar problem has beset the IMTGT project, and the IMSGT – the most prominent growth triangle in Southeast Asia – has become less of a priority for the Singapore government as the city-state has recently become more interested in developing foreign industrial parks in China and India (Dent 2002).

### 2.3.2 Second Phase Sub-Regionalism

The second phase of sub-regionalism has overlapped with the first and is more concerned with sub-regional groupings that incorporate whole national economies rather than just parts of them. For example, the Greater Mekong Sub-region (GMS) project was established in 1992 and brought together Myanmar, Cambodia, China (Yunnan Province), Laos, Thailand and Vietnam in a joint natural resource-based and infrastructure-based development project based on the Mekong river zone. The Asian Development Bank (ADB) plays a key coordinating and funding role in the project, and the GMS's sub-regional diplomacy framework is relatively well developed. The 1995 Mekong Agreement – the founding document of the Mekong River Commission – lays out the basic principles, procedures and organizational structure for a water resource regime, including the management of the dry season water flows. Within the GMS membership lies a further sub-grouping headed by Thailand, this being the Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy (ACMECS), which emerged from a proposal made by Thai Prime Minister Thaksin Shinawatra in April 2003 to develop a sub-regional Economic Co-operation Strategy between Thailand, Cambodia, Laos and Myanmar. At the inaugural ACMECS summit held in November 2003, five priorities for sub-regional cooperation were laid out, namely: trade and investment facilitation; industrial and agricultural co-operation; transport network development; tourism; and human resources development. The overarching aim was to close development gaps among the four ASEAN countries, promoting prosperity in the sub-region in a sustainable manner. A framework of 46 common projects and 224 bilateral projects were listed for implementation over a 10-year program. Vietnam joined the ACMECS project in May 2004 and international development partners comprise Canada, Australia, Japan, Singapore and the European Union.

Other sub-regional country groupings involving ASEAN member states include the Bangkok Agreement project and BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Co-operation). The Bangkok Agreement,

first signed in 1975 and then upgraded in November 2005, is a partial scope agreement between three Asia-Pacific countries (China, Laos, South Korea) and three South Asian countries (Bangladesh, India and Sri Lanka).<sup>1</sup> The six countries agreed to reduce tariffs from 1 July 2006 between them by an average of 30 percent, from 22 percent previously, and extend the agreement from 1,800 to 4,800 products, mostly in agricultural, textile and petrochemical sectors.<sup>2</sup> This new accord was renamed the Asia Pacific Free Trade Area, which somewhat overstated its scope both in geographic and trade liberalization terms. The BIMSTEC arrangement is another plurilateral FTA project involving Asia-Pacific and South Asian states, first established in 1997 between Bangladesh, Bhutan, India, Nepal, Myanmar, Sri Lanka and Thailand. In 2004, four BIMSTEC members – Bangladesh, India, Sri Lanka and Thailand – committed to abolish tariffs between them by 2012, with the other, less developed members given until 2017 to join the tariff-free arrangement.<sup>3</sup> The influence of the region's bilateral FTA trend was relatively marginal here at best. Thailand had concluded negotiations on a basic free trade agreement with India in October 2003, but its implementation was long delayed because of unresolved disagreements over rules of origin provisions. This will most likely be a difficult area of negotiation in both the BIMSTEC and Bangkok Agreement FTA projects as India in particular prefers a different approach on rules of origin (change of tariff classification and value content modalities) than ASEAN states generally, which prefer a simpler regional value content based approach.

#### 2.4 Macro-Level Developments: ASEAN's Integrational Projects

Layered on top of these various meso-level integrational projects at the sub-regional level are three main ASEAN integrational projects at the macro-level,

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<sup>1</sup> The Bangkok Agreement was originally an initiative of the Economic and Social Commission for Asia and the Pacific (ESCAP), and is Asia's oldest preferential trade agreement. India, Bangladesh, South Korea, Laos and Sri Lanka were the Bangkok Agreement's founding members, with China acceding in 2001.

<sup>2</sup> *Bloomberg News*, 02 November 2005. More specifically, China offered tariff reductions on 1,697 product lines, India on 570, South Korea on 1,367, Sri Lanka on 427 and Bangladesh on 209.

<sup>3</sup> Tariffs began to be reduced in mid-2006, with products designated for "fast track" treatment to be traded on a zero-tariff basis by mid-2009 for the three developed members and by mid-2011 for the poorer members.



that is involving the ASEAN group as a whole. These three projects are the ASEAN Free Trade Area (AFTA), the Initiative for ASEAN Integration (IAI), and the ASEAN Economic Community (AEC). There exists a considerable degree of overlap or interlock between them as we shall discuss. Let us examine the basics of each in turn.

#### 2.4.1 The ASEAN Free Trade Area (AFTA)

The idea for a regional free trade area in Southeast Asia was first formally proposed by Singapore back in 1975 at the first ASEAN Economic Ministers Meeting but other ASEAN member states such as Indonesia opposed the idea. A Preferential Trade Arrangement (PTA) scheme was introduced in 1977 as a compromise partial scope trade liberalization agreement but this achieved very little. By the mid-1980s the PTA only affected at most 5 percent of intra-ASEAN trade.<sup>4</sup> In the context of ASEAN searching for a new geo-economic rationale in the post Cold War era, the group decided at its 1992 summit to establish an ASEAN Free Trade Area (AFTA) by 2008 (Nesadurai 2003).<sup>5</sup> The main trade liberalization mechanism of AFTA is the Common Effective Preferential Tariff (CEPT) scheme, designed to reduce intra-ASEAN tariffs on trade in manufactures and processed agricultural products. The process of CEPT liberalization has been a gradual one, which began in the mid-1990s with the target date for core implementation subsequently brought forward to 2003. With ASEAN enlargement into Indochina during the latter 1990s, the new members of Cambodia, Laos, Myanmar and Vietnam – the CLMV group – were given extended deadlines to implement their AFTA commitments given the development gap that existed between them and the incumbent ASEAN-6. The supplementary ASEAN Framework Agreement on Services (AFAS) was introduced into the AFTA framework in 1995 and was followed in 1998 by the ASEAN Investment Area (AIA) scheme, which sought to induce more FDI into region based on the idea that AFTA would create a more integrated transnational space in which regional production networks could operate more effectively.

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<sup>4</sup> At 1976 Bali Accord, when the PTA was originally signed, only 71 products eligible for treatment, including infamously snow-ploughs and matchsticks. Singapore then wanted the Philippines to go with it bilaterally at a faster pace but Indonesia and others opposed this as they argued it undermine ASEAN unity.

<sup>5</sup> Singapore was again the main advocate of AFTA, tabling the proposal at the 1992 summit.

However, the 1997/98 financial crisis severely tested the commitment of certain ASEAN member states to fulfill their AFTA obligations, which prioritized resolving acute domestic economic problems over implementing regional trade liberalization (Kraft 2000; Rüländ 2000; Stubbs 2000). This especially applied to Indonesia and the Philippines, two of the largest ASEAN economies whose crisis-induced economic and political turmoil was especially pronounced. Singapore's proposal in 1998 to accelerate the pace of AFTA trade liberalization – as embodied in the Hanoi Plan of Action and Statement of Bold Measures – was opposed by the Indonesian Government. Meanwhile, the Philippines Government expressed concern over how the AFTA-induced loss of tariff revenue would significantly compromise its fiscal position. Both Indonesia and the Philippines unilaterally delayed AFTA liberalization of their respective petrochemical trade regimes,<sup>6</sup> to the particular annoyance of Singapore. In addition, tensions arose between Malaysia and Thailand over the former's decision to delay tariff reductions on automotive product imports in the AFTA schedule by three years, from 2002 to 2005 (and even then, only to 20 per cent).<sup>7</sup> Furthermore, not only did the 1997/98 financial crisis lead many ASEAN states to drag their feet on AFTA trade liberalization, but it also made AFTA itself a relatively less attractive commercial proposition given the subsequent decline of the sub-region's overall market value: the prospects for foreign investors in, and exporters to, the sub-region significantly diminished since the crisis. This partly explains why Singapore and Thailand from a comparatively early stage initiated bilateral FTA policies, in some way compensating for AFTA downward-revised market potential.

#### 2.4.2 Initiative for ASEAN Integration (IAI)

Trade integration projects such as AFTA tend to primarily benefit more developed economic zones within the trade area that are best able to exploit the new trade, investment and other commercial opportunities presented by these projects. For example, firms operating in Singapore or the Bangkok metropolitan region in Thailand or the Kuala Lumpur district in Malaysia have the infrastructural facilities, state technocratic support and the commercial experience and networks to make much more of the new market openings arising from the AFTA. Such

<sup>6</sup> *The Economist*, 06 November 2002.

<sup>7</sup> Thailand hosts Southeast Asia's biggest concentration of foreign investing automobile manufacturers.

“core” zones of development within Southeast Asia were always more likely to benefit when compared to the region’s lesser developed “periphery” zones, and from an ASEAN macro-perspective this especially concerns the CLMV group. The Initiative for ASEAN Integration (IAI), launched in November 2000, was at least partly conceived as counteracting core-periphery divergence arising from AFTA commercial liberalization. It drew in principle upon the European integration experience whereby a periphery-serving regional policy (e.g. through the Structural Fund process) was to ensure that weaker regions were better empowered to take advantage of region-wide market liberalization. The IAI’s primary objective was to bridge the development gap among ASEAN members and is specifically focused on fostering intra-regional economic development and co-operation through capacity-building and other measures.

The IAI framework developed through various stages. In July 2001, all ASEAN member states signed the Hanoi Declaration On Narrowing Development Gap For Closer ASEAN Integration<sup>8</sup> and this was followed by the introduction of the IAI Work Plan at the November 2002 summit convened at Phnom Penh. Acknowledging that, “widening of the development gap between the older ASEAN-6 members and the CLMV countries could undermine regional solidarity”, this was a six-year program (2003-2008) primarily focused on the CLMV countries but also the poorer sub-regions in the ASEAN-6 countries.

By February 2006, the IAI Work Plan had initiated 129 projects at various stages of implementation<sup>9</sup>, which comprised 20 infrastructure projects (12 transport and eight energy projects), 48 human resource development (HRD) projects, 20 information and communication technology (ICT) projects, 33 projects specifically for fostering regional economic integration and eight other miscellaneous “general coverage” projects. Of the USD37 million funding secured for the IAI Work Plan, the ASEAN-6 countries contributed almost USD21 million (56 percent of the total) while 11 dialogue partner countries and development agencies contributed the remaining USD16 million, the top five donors being

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<sup>8</sup> This committed ASEAN to “promote, through concerted efforts, effective co-operation and mutual assistance to narrow the development gap among ASEAN member countries and between ASEAN and the rest of the world for the sake of dynamic and sustained growth of our region and prosperity of all our peoples.”

<sup>9</sup> By this time, funding had been secured for 108 projects (83.7%), of which 66 projects had been completed, 24 projects were being implemented, and 18 projects were in the planning stage. Of the 21 un-funded projects, 4 have received partial funding commitment.

South Korea, Japan, India, Norway and the EU.<sup>10</sup> Table 1 shows that amongst the ASEAN-6, Singapore was by far the biggest contributor here with USD15 million committed to the IAI and Malaysia the second with just over USD3 million.<sup>11</sup> In addition, table 2 illustrates that on a bilateral basis the ASEAN-6 countries had contributed USD159.4 million by this time to the CLMV countries to implement various development projects, with Thailand making the largest contribution to the tune of around USD100 million and Singapore second with USD52 million.

*Table 1 ASEAN-6 Contribution to IAI Work Plan (at February 2006)*

Country	Funding Secured (USD)	%	Projects
Brunei Darussalam	1,500,000	7.2	5
Indonesia	599,000	2.9	5
Malaysia	3,245,814	15.6	45
Philippines	30,932	0.1	3
Singapore	14,979,121	72.1	11
Thailand	430,881	2.1	11
TOTAL	20,785,748	100.0	80

*Source: Data provided by ASEAN Member Countries to the IAI Unit of the ASEAN Secretariat.*

While these may look impressive figures in a relative sense within the group, the development divide within Southeast Asia is such that these amounts are unlikely to make a substantial difference. However, the IAI's work on closing development gaps within Southeast Asia is being augmented by the aid diplomacy of Japan, China and European countries in particular, and also by the Asian Development Bank (ADB). As part of the Japan – ASEAN Comprehensive Economic Partnership (JACEP), Japan has dedicated a fund of around USD4 billion to help narrow economic gaps among ASEAN states, enhancing the competitiveness of ASEAN countries and strengthening co-operation between

<sup>10</sup> These five accounted for around USD14 million, or 86 percent of funding by development partners. It is interesting to note that the U.S. was not in this top five, indicative of the low priority its foreign economic policy has afforded to Southeast Asian regional community-building in general.

<sup>11</sup> A proposal to establish an ASEAN Development Fund (ADF) to help further facilitate IAI objectives emerged at the 2004 APT summit. A formal agreement on creating the ADF was signed at Vientiane in July 2005 with each member state agreeing to contribute USD1 million initially.

Japan and ASEAN on issues such as institutional and human capacity. China is also trying to extend its influence through Indochina through its aid diplomacy.<sup>12</sup> The ADB's involvement with funding initiatives such as the Greater Mekong Sub-region (GMS) project is also contributing to this process.

*Table 2 ASEAN-6 Bilateral Contributions to the CLMV Group (at April 2005)*

Country	Number of Projects	Cost of Project (USD)	Date of Implementation
Brunei Darussalam	4	358,605	15 Sep-15 Dec 2002
Indonesia	18	135,054	30 Jul 2000-23 Mar 2003
Malaysia	50	4,362,151	1992-Oct 2004
Philippines	31	261,8331	1995-7 Feb 2003
Singapore	9	52,495,275	2001-2008
Thailand	97	100,358,2552	1996-2004
TOTAL	209	157,971,173	1992-2008

*Notes:* <sup>1</sup> Only the amount of 7 projects out of the 31 projects is available; <sup>2</sup> Does not include assistance in kind.

*Source:* Data provided by ASEAN Member Countries to the IAI Unit of the ASEAN Secretariat.

#### 2.4.3 The ASEAN Economic Community (AEC)

This idea for creating an ASEAN Economic Community has its roots in the 1998 Hanoi Plan of Action (HPA). Forged in the aftermath of the region's 1997/98 financial crisis, the HPA stated ASEAN's intentions to enhance greater economic and financial co-operation amongst its member states as well as accelerate AFTA progress towards implementation (Kraft 2000; Rüländ 2000). In addition, the HPA formally extended ASEAN regional economic and financial co-operation to the wider ASEAN Plus Three (APT) group (Mahani 2002). As the key implementation deadlines for AFTA approached, the group looked towards the next stage of regional economic integration. The AEC proposal originally came from Singapore at the November 2002 ASEAN summit, and was later co-sponsored by Thailand from January 2003. The AEC plan was formally proposed at the 9th ASEAN Summit held at Bali, Indonesia in October 2003.

<sup>12</sup> Research interview at the Singapore Institute for International Affairs, December 2004.

This was later formulated into the Vientiane Action Programme (VAP), another six-year plan that superseded the HPA and focused the AEC on achieving the twin aims of narrowing the development divide within Southeast Asia – thus intersecting with the IAI – and further deepening regional economic integration. The latter objective envisaged the establishment of a single or common market to promote the free flow of goods, services, people and capital within Southeast Asia. The AEC formed the “economic pillar” of a broader ASEAN Community idea, the other two pillars being security and socio-cultural in nature. A deadline was set to realize the AEC by 2020.

Although some parallels could be drawn with the EU’s Single European Market project, the AEC does not aspire to the same level of integrational ambition. For example, there would be no common external tariff (and hence no customs union) established between ASEAN member states. The diversity of development levels and trade policies (significant tariff level variance) makes such a goal difficult. However, under the AEC eleven priority sectors are selected for fast-track liberalization, namely agro-based products, air transport, automotive, e-commerce, electronics, fisheries, healthcare products, rubber-based products, textiles and apparels, tourism and wood-based products. Furthermore, early preparatory targets were set on a wide range of cross-sectional co-operative and integrative measures.<sup>13</sup> It was also originally agreed that a so called “ASEAN minus x” approach be adopted in realizing AEC objectives, whereby all member states were set a specific target to realize an objective but some members would be permitted to implement at a slower pace to accommodate for development asymmetry within the group (Cuyvers et al. 2005).

## 2.5 Overview

Regional economic integration in Southeast Asia faces many challenges as outlined

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<sup>13</sup> These included standardising custom costs and procedures, and harmonising technical regulations across the region by the end of 2004; the elimination of identified NTBs from 2005; capital controls must be progressively removed and intellectual property rights regimes strengthened, including co-operation in exchange of copyright information to take effect in 2004; visa-free travel for ASEAN nationals within the region by 2005; standardised requirements for professional services to enable free movement of professional and skilled labour within ASEAN; accelerating the implementation of mutual recognition arrangements for five priority sectors, these being electrical and electronic equipment, cosmetics, pharmaceuticals, telecommunications equipment and processed foods.

in this section. Notwithstanding the expansion of regional production network activity, intra-regional trade and investment flows remain at quite low levels. Sub-regional economic zone projects, while having ambitious aims, could be achieving more in terms of advancing regionalization links within ASEAN. At the wider macro-level, the AFTA project has faltered at times, especially in the aftermath of the 1997/98 financial crisis. The IAI project and other initiatives and measures that aim to close development gaps in Southeast Asia are impeded by significant resource constraints. Despite these difficulties, these developments at the micro, meso and macro levels inter-lock well with each other and generally work in a congruent and mutually reinforcing manner in fostering regional community-building. It therefore follows that other economic policy and diplomacy initiatives must prove they are working in a similar fashion towards this objective.

### **3 Reconciling FTA Bilateralism with ASEAN Regionalism?**

#### **3.1 The Bilateral FTA Policies of Singapore and Thailand**

The development of Singapore and Thailand's bilateral FTA policies since the late 1990s is constituent to a broader bilateral FTA trend that emerged across the Asia-Pacific from this time (Dent 2003, 2005, 2006). Free trade agreement activity in the region had been hitherto somewhat limited with just seven FTAs concluded by 1997, and none in East Asia or signed by an East Asian country with any other (see figure 1). This changed dramatically thereafter, key catalytic events being the 1997/98 East Asian financial crisis and the December 1999 Seattle WTO Ministerial Meeting debacle. The contagion-like spread of the financial crisis exposed both the extent to which regional economic interdependence had developed between East Asian countries but also the lack of co-operative mechanisms between them for coping with regional crises. Free trade agreements and financial co-operation agreements (through the APT process, such as the Chiang Mai Initiative of bilateral currency swap accords) have been the main vehicles for addressing this weakness. In the meantime, the Seattle debacle of 1999 caused many Asia-Pacific states to consider FTAs as an insurance policy based on expectations of a faltering multilateral trade system. Developments at subsequent WTO Ministerials – especially Cancun in September 2003 – served to reaffirm such pessimistic expectations. Moreover, the problems experienced with advancing the AFTA and APEC liberalization agendas after the 1997/98 financial crisis reinforced the will of Southeast Asia's most pro-free trade member

states, Singapore and Thailand, to look to FTAs as an alternative route.

Both Singapore and Thailand were at the forefront of the Asia-Pacific's new FTA trend. Singapore is Southeast Asia's most advanced economy and its development strategy has been principally based on attracting increasingly technology-intensive investments from foreign MNEs who use the city-state as a platform from which to export to other markets in East Asia, and also worldwide. Singapore's position as a regional hub economy further extends to its hosting of regional MNE headquarters and for the research, development and design centre activity for foreign MNEs. Singapore is thus a key node in regional and global circuits of capital. Securing FTAs with major trade partners is part of the same strategy, as from the city-state foreign MNEs can export their Singapore-assembled products tariff-free to a growing number of FTA partner markets. Singapore has therefore always been a fervent advocate of free trade in various levels and channels of economic diplomacy, e.g. regional, multilateral (Daquila and Huy 2003; Desker 2004; Low 2003; Rajan et al. 2001). At the 1999 APEC summit, Singapore announced its intention to commence bilateral FTA negotiations with Chile, Japan, Mexico and New Zealand. The first of these to be signed, the Agreement on a New Zealand – Singapore Closer Economic Partnership (ANZSCEP) was the first FTA concluded by an East Asian country. A number of other agreements followed with Japan, the United States, Australia, South Korea, Panama, Chile<sup>14</sup> and China, as part of a wider ASEAN – China FTA. Indeed, by the end of 2005 Singapore had concluded more bilateral FTA projects with other Asia-Pacific economies than any other in the region (see figure 2). In addition, the city-state has signed FTAs with various trade partners worldwide including India, Jordan and the European Free Trade Association (EFTA) group.

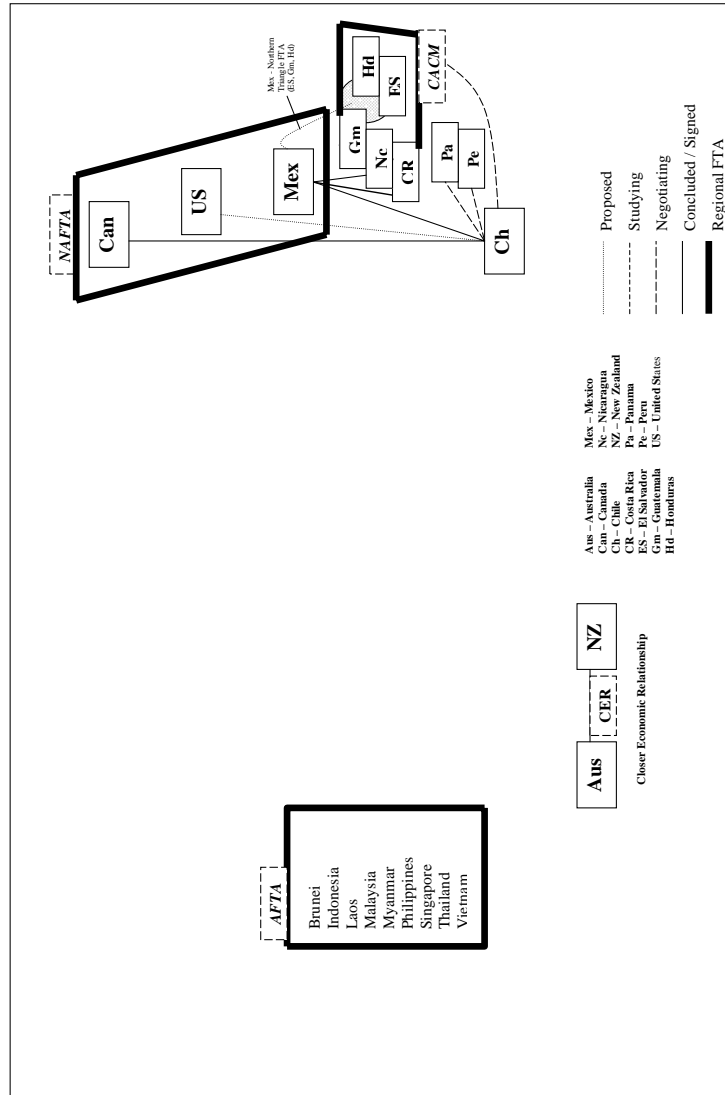
Thailand has, like Singapore, shown a penchant for developing a broad network of bilateral economic partnerships beyond Southeast Asia, and FTAs have been a principal instrument of this strategy (Dent 2006b). In December 2000, the Thai Government announced plans to explore FTA projects with a global spread of trade partners. The strategic element of this partner selection process was that many of them were core members of other regional trade arrangements: India and the South Asian Association for Regional Co-operation, Brazil and Mercosur, South Africa and the South African Development Community, the

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<sup>14</sup> As part of the quadrilateral Trans-Pacific Strategic Economic Partnership (TPSEPA) with Brunei and New Zealand.



Figure 1 Asia-Pacific FTA Projects (before 1998)



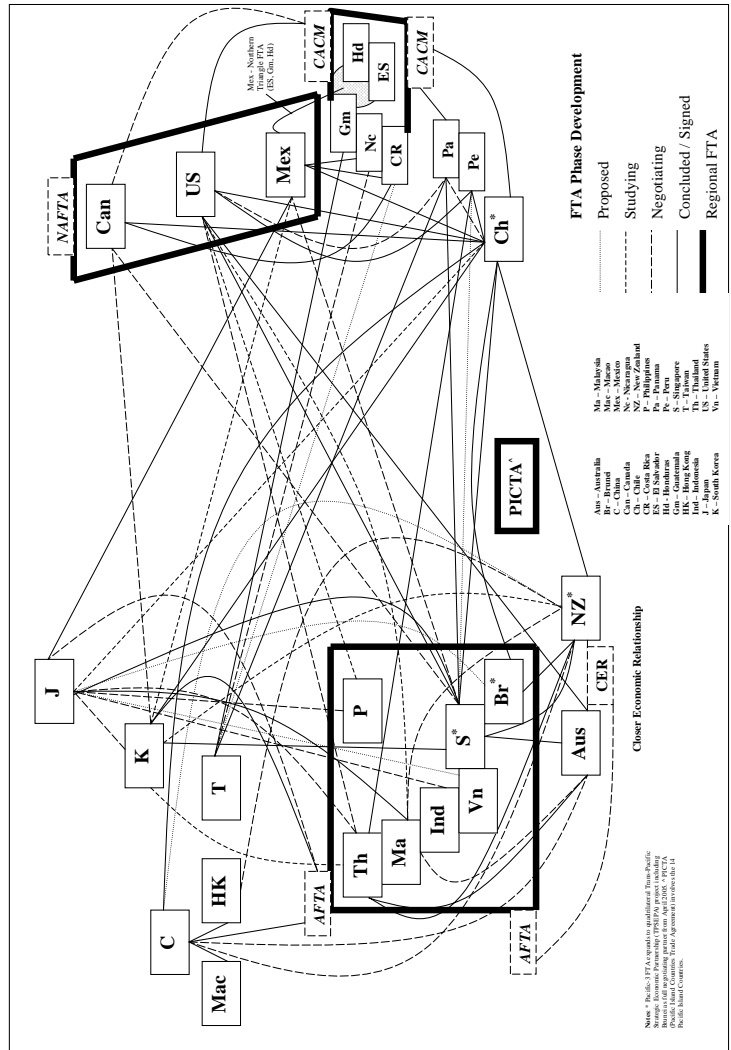
Czech Republic and the Central European Free Trade Agreement, Bahrain and the Gulf Co-operation Council, the United States and NAFTA (Nagai 2003). These bilateral FTA links are seen as bridgeheads into other global regions, while bilateral FTAs with other East Asian states would help consolidate Thailand's position as an emerging national hub economy within ASEAN. There are similarities here with Singapore's broad geo-strategic approach in that bilateral FTAs were viewed as a relatively quick and effective method to globalize Thai economic diplomacy and diversify its market access interests. By 2005 it had signed bilateral FTAs with Australia, New Zealand, China (ACFTA), Peru, India and Bahrain, and was negotiating deals with Japan and the U.S. (see figure 2).

In the meantime, the only other ASEAN member states to have signed individual FTAs with trade partners outside the region was Malaysia's bilateral with Japan (signed December 2005) and Brunei as a signatory to the quadrilateral Trans-Pacific Strategic Economic Partnership (TPSEPA) agreement along with Singapore, New Zealand and Chile. Other ASEAN member states – some of them once overtly critical of Singapore and Thailand's bilateral FTA policies as we later discuss – joined the FTA trend relatively late. A number of bilateral FTA negotiations were in progress (e.g. Malaysia – U.S., Indonesia – Japan) during 2006 but these member states lag well behind Singapore and Thailand.

### 3.2 The ASEAN Political Economy and FTAs

Singapore's ardent pursuit of bilateral FTAs was in keeping with its reputation for seeking new ways to advance Southeast Asia's integrational ambitions, both in intra-regional and extra-regional senses. Taking the intra-regional perspective first, it was previously noted that Singapore was AFTA's earliest advocate from the 1970s and it was a Singaporean proposal that led to the project's initiation in the 1990s. Along with Thailand, it has also frequently called for the 2020 deadline of the AEC (another Singapore led proposal) to be brought forward by a few years, most recently by Prime Minister Lee Hsien Loong at the May 2006 ASEAN Economic Ministers Meeting although, like before, most other member states did not support the idea. Over the last few years Singapore has sought a closer relationship with Thailand as a like-minded bilateral partner within ASEAN with which it could force the pace of integrational change in Southeast Asia. This culminated in the Singapore – Thailand Enhanced Economic Relationship (STEER) that was formally established in August 2003. At STEER's launch, Singapore and Thailand announced their intention to build a bilateral foundation

Figure 2 Asia-Pacific FTA Projects (by end of 2005)



for greater economic integration within ASEAN based on a “*one economy, two countries*” approach. Therein, both sides sought to strengthen their bilateral economic co-operation, liberalization and integration across various fields.<sup>15</sup> There were many politico-economic similarities and ties between Singapore and Thailand. Both could be considered as corporatist states with a top-down approach to policy-making and political governance. Their respective political leaderships (the Thaksin and Lee families) also allegedly had close business ties with each other,<sup>16</sup> and the links between Singaporean and Thai business elites were reported to be strong generally.<sup>17</sup>

STEER is a unique bilateral agreement within ASEAN and many other member states have expressed some concern regarding its exclusive “AFTA-plus” nature. This connects to the wider issue of how Singapore and Thailand’s so called “pathfinding” approach to economic integration generally at the bilateral and regional levels. It particularly relates to the “2 plus x” principle championed by Singapore and Thailand in relation to ASEAN integration, whereby two member states should be allowed to pioneer integration on a bilateral basis initially with other members states open to join at a later date when ready. In a speech given by Singapore’s Minister for Trade and Industry, George Yeo, around the time of the October 2003 ASEAN Summit, he explained the “2 plus x” approach in these Darwinesque terms: “it is better to catch up with those who are faster than to be dragged back by those who are slower.” Furthermore, in acknowledgement to the STEER framework, PM Thaksin suggested that Thailand and Singapore should “tango” first in this regard, thus advancing toward their AEC objectives ahead of other ASEAN members. This ran somewhat counter to the aforementioned “ASEAN minus x” approach that had been consensually agreed as the process by which the AEC would be realized, whereby the emphasis lay more on group consent and accommodating weaker members that was in contrast to the “2 plus x” formula that allowed stronger pairs of members to surge ahead of the group. While Singapore and Thailand have argued that their integrational ambitions

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<sup>15</sup> These included the automotive industry, electronics, agro-based products, air transport, trade and investment promotion, healthcare, tourism, transport logistics, financial services, information and communication technology, small business formation, and mutual recognition agreements.

<sup>16</sup> This was cited by many research interviewees from across Singapore, Malaysia and Thailand, December 2004 (Singapore and Malaysia), July 2005 (Thailand).

<sup>17</sup> For example, according to one research interviewee a number of high profile Thai business people are advisors to big Singaporean firms. Research interview, Bangkok, Thailand, July 2005.

should not be constrained by the “convoy problem” of having to proceed at the pace of slower member states, the “2 plus x” approach has not gained ground within ASEAN. Many other ASEAN members believe it to be divisive by creating a further tier within the group that is already stratified along ASEAN-6 and CLMV sub-group layers.<sup>18</sup>

Nevertheless, Singapore and Thailand still continue to defend the Darwinesque logic of the “2 plus x” approach, and have applied its principle to their bilateral FTA projects with countries outside the region: that is that ASEAN members should be allowed to sign individual FTAs with others if they are able, with others following on afterwards. When Singapore first developed its bilateral FTA policy, it drew much criticism from Malaysia in particular. There were two main elements to this criticism. The first concerned the technical policy issue of how bilateral FTAs with extra-regional partners could possibly undermine the integrity of AFTA. In February 2001, Malaysian Prime Minister Mahathir Mohamed expressed concern about the trade deflection problem of semi-finished products from bilateral FTA partners entering Singapore, then being fully completed in the city-state and thereafter securing “back door”, zero-tariff entry into the wider AFTA market.<sup>19</sup> In reply, Singapore stated that the rules of origin in its FTAs did not permit such trade deflection to occur, implying that Singapore-made exports were sufficiently locally sourced to legitimately qualify for access to the AFTA market.<sup>20</sup> While this was correct in theory, it depended upon the strictness of such rules and how effectively they were being applied. Moreover, the second element to Malaysia’s criticism – the politico-economic – was arguably more important than the first. In an article published in the *New Straits Times* in July 2001, former Malaysian Government minister, Ramon Navaratnam, argued that, “Even if Singapore’s Free Trade Agreements are consistent with AFTA and WTO, the real issue is whether Singapore’s unholy haste is consistent with the ASEAN spirit of optimizing co-operation, consultation and fraternal goodwill, in the longer term.”<sup>21</sup> The broader point here is that

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<sup>18</sup> This view had been particularly expressed by Malaysia, Indonesia and Brunei. Research interviews in Jakarta, Indonesia and Bangkok, Thailand, July 2005.

<sup>19</sup> *Straits Times*, 26 February 2001.

<sup>20</sup> The CEPT programme dictates that AFTA-qualified products require a minimum of 40 per cent ASEAN local content.

<sup>21</sup> *New Straits Times*, 16 July 2001.

bilateral FTAs could compromise the regional community-building purpose of AFTA by focusing trade links and economic diplomacy efforts from inside the region to outside it. This was notwithstanding, of course, Singapore's efforts to accelerate the pace of regional economic integration within Southeast Asia. Malaysia soon had to capitulate, however, as other ASEAN states such as the Philippines, Indonesia and Brunei also looked to initiate bilateral FTA policies of their own by 2002. Soon thereafter, Malaysia felt compelled to join the new FTA trend to avoid isolation, and proposed separate projects with Japan and the U.S. by the end of that year.

Like Malaysia, other ASEAN member states were nevertheless somewhat concerned about the effect Singapore's and then Thailand's bilateral FTAs would have upon the ASEAN group. Many did understand Singapore's motives given the city-state's extensive regional and global links, and thus how its FTA policy was a function of its economy's deep engagement in regionalization and globalization processes. Indeed, Singapore argued that its FTAs with the U.S. and Japan in particular would help draw higher levels of FDI into the city-state that in turn would have positive externalities for other ASEAN member economies. This would mostly be transmitted through the regional production network (RPN) linkages and other mechanisms, such as the Integrated Sourcing Initiative (ISI) arrangement in which goods produced on Indonesia's Batam and Bintan Islands industrial parks (which were originally established and still managed with the help of Singaporean quasi-government agencies) would be eligible for tariff-free entry into the U.S. under the terms of the U.S. – Singapore Free Trade Agreement (USSFTA).<sup>22</sup> Yet ASEAN level integration would be more ideal in this respect, both intra-regionally (i.e. AFTA, AEC) and extra-regionally (e.g. ACFTA). It is also rather ironic that Malaysia held out for so long against the bilateral FTA trend because out of the rest of the ASEAN group (i.e. not including Singapore and Thailand) it possessed by far the strongest technocratic, institutional and industrial capacities required to initiate a bilateral FTA policy. Even middle-order newly industrialized economies such as Indonesia and the Philippines face significant capacity constraints in doing so, an issue to which we later return.

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<sup>22</sup> There are around 700 foreign companies operating in the Batam Island industrial park, 70 percent of which are Singapore-based, and mostly involved in information technology and electronics production as part of wider regional production networks operating in Southeast and East Asia.

While it looked as though the Singapore – Thailand alliance on ASEAN's integrational affairs and other matters was set to strengthen through the STEER framework, fault-lines began to emerge in 2005 and 2006. Firstly, nothing of much substance appeared from STEER related initiatives themselves, leading some even with government circles to refer to it as simply a political marketing exercise.<sup>23</sup> At a more fundamental level, many believed the natural foundations to a long-term Singapore – Thailand alliance were weak. Some contended that Singapore's more obvious bilateral "alliance" partner was Malaysia given the extensive commercial and ethnic ties as well as their geographic proximity.<sup>24</sup> By the same token, Thailand's more natural politico-economic partners lay in Indochina, such as Vietnam.<sup>25</sup> Furthermore, others have noted that intensifying competition rather than co-operation is the main defining feature of Singapore – Thailand relations. For example, regarding infrastructural competition, Thailand's new Bangkok airport project is challenging the position of Singapore's Changi Airport as Southeast Asia's main regional air transportation hub.<sup>26</sup> Furthermore, the close links between the political leaderships of both countries, the Thaksin – Lee axis, was placed under extreme duress as a consequence of the Shin Corp affair. Shin Corp, Thailand's largest telecommunications firm, was founded and 49.6 percent owned by Thai PM Thaksin Shinawatra and his family. In January 2006, it appeared that Shin Corp was being sold in a tax-free deal estimated at USD1.9 billion to Temasek Holdings, the Singapore government's state investment arm

<sup>23</sup> Research interview with Thai Ministry of Affairs official, July 2005.

<sup>24</sup> However, relations between Singapore and Malaysia remain beset with disputes, such as over freshwater supply contracts and infrastructural issues. The most recent of these concerns Malaysia's proposal in 2005 to replace the causeway linking the countries with a bridge, which Singapore refusing to comply with citing the high costs of construction as a reason. Impatient with the delay, Malaysia at one point decided to proceed with building its half of the bridge regardless of whether Singapore built the other half or not. However, by April 2006 the Malaysian Government announced it was scrapping its bridge building plan.

<sup>25</sup> Research interviews with various government and research institute representatives, Southeast Asia, December 2004 and July 2005.

<sup>26</sup> In addition, Thailand's Kra Isthmus canal project, which would cut through Malaysian peninsula and thus bypass Straits of Malacca, could if built undermine the strategic importance of Singapore's port complex and as a entrepot trade centre generally. However, this project is technologically very difficult for geological reasons (e.g. tides, shallow waters, ground height differentials), but as an alternative Thailand is looking to construct an oil pipeline across the narrowest point of the Isthmus to shorten the oil supply line from the Middle East to East Asia.

that happened to be run by Singapore PM Lee Hsien Loong's wife, Ho Ching. The public outcry in Thailand against both Singapore and the Thaksin Government concerning the sale of an asset of such national strategic importance placed considerable pressures upon the countries' bilateral relationship.<sup>27</sup>

### 3.3 FTAs with the U.S., Japan and China

#### 3.3.1 The U.S. – Singapore Free Trade Agreement (USSFTA)

Singapore's FTA with the United States was the first agreement of its kind the U.S. had signed with an Asian country. The first round of talks commenced in December 2000 and the deal was concluded after 11 formal rounds in January 2003. In defense of the agreement and the preferential treatment it afforded Singapore in the U.S. market, then PM Goh Chok Tong had tried to sell the project to its Southeast Asian neighbors as further anchoring American interests in their region, and that Singapore would not get any first mover advantages. Goh believed that the USSFTA would soon pave the way for the U.S. to sign FTAs with many other ASEAN countries, especially since Washington advocated the use of its Enterprise for ASEAN Initiative (EAI) framework to facilitate this on a bilateral basis. New bilateral FTA projects between the U.S. and selected ASEAN countries, with Malaysia and the Philippines (both first proposed in October 2002), and Thailand (proposed in June 2003) but the development of these projects have been difficult. The main problem concerns the type or model of FTA the United States presses for in negotiations, which can be a significant capacity challenge even for ASEAN's advanced developing countries.<sup>28</sup>

When the U.S.'s FTA negotiators first met with their Thai counterparts, they reportedly presented them with the USSFTA text and informed them that this was essentially the template they wanted to use for a U.S. – Thailand Free Trade Agreement (USTFTA).<sup>29</sup> Rather taken aback, the Thai negotiators rightly reminded their American guests that each FTA was unique: a bespoke outcome

<sup>27</sup> *The Guardian*, 24. March 2006.

<sup>28</sup> This even applied to Singapore in certain respects. For example, a survey conducted by the Singapore Business Federation found that many of the city-state's smaller firms were experiencing difficulties with understanding the USSFTA's multitudinous product-specific rules of origin stipulations. A government 'outreach' group was subsequently deployed to explain how to deal with RoO aspects of the FTA. Research interviews with Singapore Business Federation and Institute of Southeast Asian Studies representatives, Singapore, December 2004.



from the particular politico-economic interactions between the trade partners concerned. Thailand was not Singapore, and allowances had to be made for this. Singapore government officials themselves made the point that the USSFTA possessed many “WTO-plus” elements, citing provisions on intellectual property rights (IPR) that, for example, went beyond accords signed thus far at the WTO.<sup>30</sup> While Singapore’s technocratic and institutional capacity was sufficiently robust to accommodate American demands on IPR compliance, relatively weaker capacity ASEAN did not enjoy the same “advantage”. Hence, when the U.S. reportedly pressed Thailand to incorporate a 25-year period rule for enforcing drug patents in its FTA negotiations with Thailand during 2005 (in doing so looking to extend beyond the maximum 20-year period norm under WTO rules) as well as lift restrictions on the market price of American pharmaceutical products, fierce opposition from various Thai civil society groups ensued.<sup>31</sup> There was also public concern that the U.S., as it usually did, would press Thailand into adopting core elements of the U.S.’s national IPR regime (e.g. the 1998 Digital Millennium Copyright and Copyright Term Extension Acts) that go well beyond the WTO’s Trade-Related Aspects of Intellectual Property (TRIPS) agreement. At the same time, the U.S. insisted on retaining a broad spread of protectionist barriers on Thai agricultural and other products. Amidst a combination of technical policy differences between Thai and American negotiators and domestic political pressures, Thailand’s chief USTFTA negotiator resigned his position in January 2006.<sup>32</sup> Two months later in March, the Thai government decided to put USTFTA talks on hold owing to domestic political factors (an under pressure Thaksin administration) and unresolved differences in the negotiations on IPR and other issues.<sup>33</sup>

Learning from the experience of other Asia-Pacific states that had entered into FTA negotiations with the U.S., Malaysia had taken some time conducting a series of cost-benefit and feasibility studies on the impact such an agreement would have upon the Malaysian economy. It was almost four years after a U.S. – Malaysia free

<sup>29</sup> Research interviews with Thai government and research institute representatives, Bangkok, July 2005.

<sup>30</sup> Research interview with Singapore government officials, December 2004.

<sup>31</sup> *Asia Times*, 14 April 2005.

<sup>32</sup> *The Nation*, 18 January 2006.

<sup>33</sup> *Reuters*, 01 March 2006

trade agreement (USMFTA) had first been proposed that negotiations actually commenced in June 2006. No doubt observing the difficulties experienced by Singapore, Australia and Thailand in their FTA talks with the U.S., Malaysia stated a month before USMFTA negotiations were due to start that it would not rush the negotiation process, nor sign any deal that placed undue duress upon the country's development capacity. Meanwhile, as per usual practice, the U.S. has pressed the Philippines to sign a trade and investment framework agreement (TIFA) as a prerequisite to initiating bilateral FTA negotiations. A TIFA is designed as a "capacity test" for prospective FTA partners for the U.S., evaluating whether the country concerned is able to comply with the "behind the border" market access demands of American commerce. By mid-2006 the Philippines had yet to sign a TIFA with the United States.

### 3.3.2 Dealing with Japan and China

Development assistance has long been a key aspect of the Japan – ASEAN economic relationship. Southeast Asia was the recipient of between 30 to 40 percent of Japan's total annual foreign aid budget. The expansion of Japanese MNE activity in the region from the mid-1980s onwards further cemented the relationship with Japan's interests increasingly focused on improving the techno-industrial capacity of local supplier firms that served of production networks of the *keiretsu*. This emphasis on development co-operation was consistent with Japan's emerging approach to FTAs at the millennial eve, that is to embed trade liberalization within a broader "economic partnership agreement" or EPA, and was in contrast to the more overt neo-liberal approach adopted by the United States where market access issues solely determined the FTA negotiating agenda. The idea of establishing an FTA between Japan and ASEAN arose out of a broader Japan – ASEAN Comprehensive Economic Partnership (JACEP) agreement that was first proposed in January 2002 by Japanese Prime Minister Junichiro Koizumi, and later signed in November that year. It is generally acknowledged that JACEP was a quickly put together response to the ASEAN – China Framework Agreement (containing an FTA element, ACFTA) that was signed in November 2001 with a view to realize ACFTA by 2010 (Kagami 2003). However, it was not until November 2004 that Japan and ASEAN formally decided to proceed with an FTA element to JACEP, the first round of negotiations taking place in April 2005. By then, ACFTA talks had been more or less concluded.

There were interesting contrasts and similarities between both the nature and

the process of the ACFTA and JACEP projects. In the nomenclature of both was an expressed desire to advance regional economic co-operation in Southeast and East Asia, with provisions focused on fostering co-operation in various fields of endeavor, e.g. agriculture, education, ICT, science and technology, SME development. If resources were forthcoming to help realize the development co-operation objectives embodied by both agreements then this would certainly have a positive effect on regional community-building. This was the most important commonality between ACFTA and JACEP. Because China and ASEAN were both essentially developing country trade partners, the ACFTA negotiating agenda was relatively simpler and less complex than JACEP's. Market access negotiations in ACFTA primarily concerned goods trade liberalization and some services trade liberalization (Tongzou 2005, Wong and Chan 2003). Furthermore, it included simple generic rules of origin that were modeled on AFTA's 40 percent "regional value content" (RVC) approach. The relatively basic or lower common denominator nature of ACFTA allowed ASEAN to negotiate with China as a group. Singapore and Thailand had, though, pressed China to proceed bilaterally to broker separate and more sophisticated deals in advance, and therein possibly confer greater advantages over their fellow ASEAN members. However, Beijing refused their requests. In contrast, FTA negotiations within JACEP have all been conducted on a country-to-country bilateral basis. As Japan's commercial and regulatory interests are more complex than China's (e.g. on "FTA plus" issues such as IPR and investment rights), Tokyo insisted that only separate bilateral negotiations would allow for the more flexible approach required to meet those interests, as well as take into account the development asymmetry of the ASEAN group.<sup>34</sup> ASEAN member states had at first wanted to proceed on a group basis,<sup>35</sup> as it had done with China, but eventually acquiesced to Japan's demand, although the idea was that common JACEP objectives were to be pursued through parallel bilateral talks, e.g. on general trade liberalization, rules of origin regime, etc. Thus, some degree of convergence and harmonization between these separate bilateral deals was to be achieved as JACEP's implementation deadline of 2012 approached.

Singapore had of course already signed a bilateral FTA with Japan (the JSEPA)

<sup>34</sup> Research interview with Thai government officials.

<sup>35</sup> Research interviews with Thai, Malaysian and Indonesian government officials, December 2004 and July 2005 in respective country capitals.

and by 2006 Japan had initiated other bilateral negotiations with Thailand, Malaysia, Indonesia, the Philippines and Vietnam. However, a number of problems soon became apparent with this bilateral approach. First, Japan was able to play one ASEAN member state off against another, offering relative market access advantages over other members to those more compliant to Tokyo's wishes. By not acting as a group and insisting on "most favored nation" (MFN, i.e. non-discriminatory) treatment to be applied to all member states, ASEAN lost an important negotiating advantage and moreover allowed competitive bilateralism to prevail amongst the group. For example, Japan wanted to do different deals on steel with different ASEAN states in accordance to the competitive threats it faced from Southeast Asian countries in different steel sectors. Thailand sought the Malaysian deal with Japan on steel (5 percent tariff maintained for 10 years) and prolonged negotiations ensued on this issue. In addition, tensions between Malaysia and Thailand were further fuelled after Malaysia secured their bilateral FTA with Japan well ahead of Thailand in May 2005, despite them both commencing negotiations at the beginning of 2004.<sup>36</sup> Many ASEAN countries also felt that Japan was being unreasonable in certain areas of FTA talks, for instance demanding that AFTA's 40 percent RVC rules of origin apply to its exports to Southeast Asia whereas ASEAN exporters had to comply with a complex range of product-specific rules when exporting to Japan.<sup>37</sup>

While most ASEAN member states had resisted such demands by Tokyo, there was virtually no co-ordination between them in their separate bilateral FTA talks with Japan.<sup>38</sup> This ran counter to the principle of regional unity and also posed a problem for harmonizing and converging the bilaterals into a common JACEP framework.<sup>39</sup> The JACEP plan was that Japan's bilateral FTAs with ASEAN

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<sup>36</sup> *E-Sinchew-i.com News*, 27 May 2005.

<sup>37</sup> Research interview with Thai FTA negotiator, Bangkok, July 2005.

<sup>38</sup> There was reportedly some exchange of information amongst ASEAN member states but most research interviewed government officials conceded not a great deal. For instance, the Philippines and Malaysia did share some details with other members about their bilateral talks with Japan, mainly on concessions made on agriculture and automotive sector products. Research interviews with government officials in Kuala Lumpur (December 2004) and Jakarta (July 2005).

<sup>39</sup> In ACFTA negotiations, the ASEAN Secretariat acted as a coordinating agent between rounds of talks, sending off mutually endorsed papers from ASEAN for China to look at. This was the general framework of talks but there were also specific sectors that were dealt with more on a bilateral or sub-group basis. Research interviews with ASEAN Secretariat representatives, Jakarta, July 2005.

should all be in place by 2007 leaving another five years to merge them into one Japan – ASEAN arrangement by 2012. An interviewed Thai Ministry of Commerce remarked, however, that harmonizing the different bilateral RoO and tariff liberalization schedules of separate bilaterals into one ASEAN level agreement would be “a headache” and FTA negotiators from all sides were still not sure how this will be achieved.<sup>40</sup> Overall, there appears to be a general view amongst research interviewed ASEAN government officials that Japan was a far more difficult FTA negotiator than China.<sup>41</sup> Whatever the case, the bilateral approach to FTA negotiation proved the more divisive and was seen by most to work against regional community-building in Southeast and East Asia. Learning lessons from this, ASEAN convinced South Korea to negotiate on a group basis with its own FTA negotiations.

#### 4 Capacity Issues and Development Assistance

The ability of developing countries to negotiate an FTA that suits their economic interests, effectively implement the agreement’s provisions, and also successfully exploit the commercial opportunities arising from the agreement ultimately depends on their capacity to achieve these ends (UNCTAD 2004). This is more critically the case for bilateral FTAs because developing countries cannot necessarily rely on their fellow regional group members (e.g. AFTA and ASEAN) for capacity assistance as such. By “capacity” we are referring to the various development-related functions of the nation concerned, primarily comprising:

- *Technocratic capacity*: the quality and quantity of the nation’s technocrats, either directly employed by or seconded to the government, that can be drawn upon to develop FTA projects (e.g. as negotiators or study analysts) and a robust FTA policy generally.
- *Industrial capacity*: the ability of the economy’s industrial sectors to expand operations in newly created FTA markets, and therein undertake necessary structural adjustments required to compete effectively within those markets.
- *Institutional capacity*: the ability of the nation’s institutional frameworks (e.g. legal, socio-cultural) to accommodate the various policy-related commit-

<sup>40</sup> Research interview, Bangkok, July 2005.

<sup>41</sup> An additional reason for this not mentioned thus far were the inter-ministerial conflicts that beset the Japanese government when negotiating with any trade partner, especially over agricultural trade.

ments incorporated into the FTA, such as on intellectual property rights and competition policy. Examples of “institutions” in this sense mainly relate to agencies (e.g. anti-trust regulators, patent regulators) and associated laws and rules devised to enforce legislation once enacted.

Most ASEAN member states face capacity constraints when developing an FTA policy, but some much more than others. Only Vietnam from the CLMV group has sufficient capacity to develop some kind of FTA policy, and from early 2006 began preliminary bilateral talks with Japan – its very first project. Yet even Vo Tri Thanh, Director of the Vietnam Government’s Department for Trade Policy and International Integration Studies commented at the time, “I think that with the limited staff it currently has, it would be very difficult for Vietnam to conduct quality negotiations.”<sup>42</sup> As previously noted, middle-order NIEs like Indonesia, the Philippines and Brunei have too experienced real difficulties in initiating their own bilateral FTA policies. For example, in their report published by the Philippine Institute for Development Studies, Medalla and Lazaro (2004) argued that the country had a weak technocratic and institutional framework for developing and negotiating FTA projects, and that the Philippines had appeared more of a passive negotiator or participant in its FTA projects. Not only did the country suffer from having only a small pool of sufficiently skilled and technically trained FTA negotiators but also public regulations on issues such as IPR and quarantine lacked the robustness demanded by more developed FTA partner countries, like the U.S., Japan and Australia. Medalla and Lazaro (2004) also noted that the government has no concrete strategies or well defined policies toward FTAs. It was their view that the government had not sufficiently mapped out industry-by-industry adjustment and competitiveness strategies with industry leaders so as to maximize the potential commercial benefits of FTAs for the economy. The author’s own research also indicated that Indonesia faces very similar capacity challenges.<sup>43</sup> Furthermore, a research interviewed Indonesian

<sup>42</sup> *VietNamNet*, 13 March 2006.

<sup>43</sup> Field research conducted in Jakarta, July 2005. To illustrate this point further, an interviewed research analyst involved in ACFTA impact studies made the following observations in relation to capacity differentiation within ASEAN: “Malaysia was not sure how far it wanted to proceed in the early rounds of talks and the Philippines was also tentative, sending different negotiating teams for each round and citing problems with civil society back home in order to delay progress a little. The Indonesian team never said that much. Myanmar wanted a lot of special treatment. Cambodia and Laos did not say anything and Brunei was very quiet. Vietnam sent young but

government official was of the view that Singapore's "WTO plus" approach to FTAs is not that helpful to developing countries because they set too high a standard and precedents (e.g. on IPR) that countries with much weaker technocratic and institutional capacity find hard to comply with.<sup>44</sup> This issue was discussed earlier in relation to the USSFTA.

The profusion of bilateral FTAs developed by ASEAN's stronger member states risks exacerbating the development divide in Southeast Asia, and therein work counter to the regional community-building efforts of the sub-region and region-wide integrational projects discussed earlier, e.g. ACMECS, AFTA, IAI. This is primarily because the more advanced developing countries like Singapore, Thailand and Malaysia (i.e. the ASEAN "core-zone" economies) have stronger export industry capacities than their less advanced "periphery-zone" counterparts. Thus, FTA conferred preferential access to developed country markets will spur the export-led growth rate of the former yet further ahead of the latter, thus prospectively leading to greater divergence in income levels between the region's states generally. There are additional economic benefits that will accrue to core-zone countries from enjoying closer commercial ties with significant trade partners through FTAs, such as increased levels of foreign direct investment and technology transfer.

The development divide problem exacerbated by bilateral FTAs can be addressed by compensating measures to improve the economic capacity of ASEAN's lesser developed members, this being over and above what is already being planned within the IAI framework in relation to regional market integration schemes such as AFTA and AEC. However, these additional compensating measures have not been forthcoming. Singapore government officials have acted as "FTA tutors" to their ASEAN counterparts when asked, sharing their knowledge and experiences of negotiating FTAs with others. Singapore and Thailand also have development assistance policies in which lesser-developed ASEAN countries are beneficiaries. Thailand's policy is centered on aforementioned sub-regional projects, especially the ACMECS and GMS. Obtaining data on Singapore's aid policy is notoriously difficult but there is a strong emphasis on conferring techni-

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talented negotiators and demanded a lot. Singapore was proactive and wrote things up because they had the best English and were the most technocratically skilled. Thailand also sent a strong team and was the lead negotiator in the early rounds." Research interview, Bangkok, July 2005.

<sup>44</sup> Research interview, Jakarta, July 2005.

cal assistance rather than financial assistance to its recipients (Dent 2002). The main reason given for this is that technical assistance is non-corruptible whereas financial assistance is open to corruption in the receiving country. Despite this argument, the CLMV countries have called upon Singapore to be more generous with its aid policy, especially given the huge financial surpluses the city-state has at its disposal. It was previously established that Singapore has made significant contributions to the CLMV group relative to other ASEAN member states, but relative to the city-state's financial resources these are comparatively very small indeed.<sup>45</sup> Furthermore, the more advanced members of ASEAN need to afford more priority to attracting higher levels of development assistance from outside the region. We have already noted the importance of Japan's contributions in this regard, and the development co-operation dimension to its preferred "economic partnership" approach to FTAs. ASEAN member states should ensure that Tokyo makes good on promises made regarding the latter and that there is real substance to development co-operation provisions negotiated in JACEP outcomes.

## **5 ASEAN Economic Integration and Bilateral FTAs: Pulling in Opposite Directions?**

Before summarizing the main arguments of this paper, we should restate that free trade agreements are heterogeneous entities and can vary significantly in terms of technical policy content, underlying philosophical approach, number of partners involved (e.g. bilateral, plurilateral, regional) and so on. Figure 1 illustrates this generically with regard to thematic content variance in Asia-Pacific FTAs and figure 2 specifically concerning different rules of origin regimes. Region-level (e.g. ACFTA, AFTA) FTAs are most likely to positively contribute to regional community-building in Southeast Asia simply because they are based on the principles of inclusion and equity of interest, as should be reflected in the negotiation process and the final agreement itself. Further regional community-building value is added when such agreements incorporate, or are combined with, development co-operation measures aimed at enhancing the technocratic, institutional and industrial capacities of "periphery-zone" countries within the region, in Southeast Asia's case mainly the CLMV group. Development gaps

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<sup>45</sup> For example, when compared to the USD100 billion of foreign exchange reserves managed by the Singapore state's Government Investment Corporation. Singapore is around the fifth largest retainer of such reserves in the world, and the world's highest in per capita terms.



within ASEAN are already being addressed by macro-level projects like the Initiative for ASEAN Integration (IAI) as well as to a lesser extent meso-level projects such as ACMECS. However, these require more substantive support from Southeast Asia's main economic partners to make a real difference, and in the meantime FTAs must not work counter to the objectives of these projects. This paper has argued that *bilateral* FTAs pose the most significant risks in this regard.

Bilateral FTAs signed by Southeast Asia's strongest economic powers will have some positive regionalization effects, especially when they involve Singapore and Thailand, the region's two most important hub economies. Nevertheless, these hub "core" economies will still benefit by far the most in the economic geography context from FTA-induced rises in export-led growth and inward foreign investment. Multi-level economic integration is the reality in Southeast Asia, yet bilateral FTAs could significantly exacerbate the development divide in the region. Even when developed countries like Japan incorporate development assistance measures within their free trade / economic partnership agreements, these have been to date directed towards stronger ASEAN economies ahead of weaker countries because the latter face significant capacity constraints in operationalizing a bilateral FTA policy. We have noted how the capacity constraint issue and bilateral FTAs has a number of dimensions to it. Developed country partners are already making heavy demands upon the capacity functions of ASEAN member states in many areas (e.g. IPR compliance) through bilateral FTA negotiations. This can incur relatively high costs on Southeast Asian countries and even damage their development prospects. For example, in USTFTA talks the U.S. insisted that Thailand open up its infant e-banking industry to the might of American competition.<sup>46</sup> Weaker developing countries are at a far greater technocratic capacity disadvantage in bilateral negotiations with developed countries when compared to dealing with them in plurilateral negotiations (e.g. regional, multilateral) because the relational power advantage of developed countries is circumscribed by the collective membership in plurilateral frameworks. Bilateral FTAs only serve to reinforce existing power asymmetries between developed and developing countries, especially where the developed country demonstrates far less interest in providing development capacity assistance to its weaker partner,

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<sup>46</sup> *The Nation*, 22 September 2005.

the U.S. being particularly culpable here.

As we have also discussed, the competitive bilateralism arising amongst ASEAN member states as they individually pursue FTAs with extra-regional partners can undermine the regional community-building process. It is better to proceed on a consensual “most favored nation” basis in such circumstances, whereby a concession won by one ASEAN country with an FTA partner is then extended to all others on an equal, non-discriminatory basis, yet this is not happening. In the further interest of upholding Southeast Asia’s regional solidarity, if Singapore and Thailand continue advocating the economic Darwinian approach to ASEAN economic integration and bilateral FTAs – allowing stronger member economies to exert competitive disciplines upon the rest of the group – then they should concomitantly be doing more (especially the financial resource-rich Singapore) to enhance the development capacity of Southeast Asia’s periphery zone countries, devoting their considerable economic diplomacy skills increasingly to these ends. International market liberalization and integration are useful mechanisms for improving economic efficiency and welfare but weaker participating economies must be capacity empowered to more effectively exploit the according opportunities presented within this dynamic economic region.

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