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Hadi Soesastro

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Hadi Soesastro
Australian National University
Canberra
and
Centre for Strategic and International Studies
Jakarta

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Australia–Japan Research Centre
Asia Pacific School of Economics and Government
The Australian National University
Canberra ACT 0200

Telephone: (61 2) 6125 3780
Facsimile: (61 2) 6125 0767
E-mail: ajrc@anu.edu.au
URL: <http://apseg.anu.edu.au>

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AN ASEAN ECONOMIC COMMUNITY AND ASEAN+3: HOW DO THEY FIT TOGETHER?

ASEAN economic cooperation is simultaneously deepening (through commitment to the establishment of an ASEAN Economic Community) and widening (through greater cooperation with China, Japan and South Korea). How can these potentially divergent paths be reconciled, especially when, at the highest policy level, the emphasis of ASEAN+3 cooperation has moved away from region-wide efforts and towards separate ASEAN+1 agreements focused on trade. The author concludes that the leaders of the ASEAN+3 countries should not focus on bilateral FTAs; rather, they should immediately make a systematic effort to form an East Asia Free Trade Area. Some guidelines recently outlined by the PECC Trade Forum may provide some assistance.

Introduction

At the ASEAN summit in October 2003 in Bali, ASEAN leaders declared that an ASEAN Community would be established. One of the three pillars of the ASEAN Community is the ASEAN Economic Community (AEC). The other two are the ASEAN Security Community and the ASEAN Socio-Cultural Community.

As stated in the declaration of ASEAN Concord II (Bali Concord II), the AEC is the realisation of the end-goal of economic integration, namely 'to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities' in 2020.

With the decision to realise an AEC, ASEAN countries are clearly moving towards deeper economic integration. Since 1997, ASEAN has also embarked on a process to expand economic cooperation with its neighbours in the north, namely China, Japan and South Korea. In a way, this process can be seen as a kind of widening of economic integration. The ASEAN+3 process now involves summits amongst heads of states, meetings of foreign ministers, economic

ministers and finance ministers, and meetings of senior officials. At the fifth summit in Brunei Darussalam in November 2001, ASEAN+3 leaders endorsed the vision of an East Asian Economic Community that was proposed by the East Asia Vision Group. The East Asian Economic Community is to be realised, among other means, through the creation of an East Asian Free Trade Area.

How will these two processes, deepening and widening of economic integration, fit together?

From a strategy perspective, ASEAN has been engaged in a number of wider regional or inter-regional cooperation arrangements on the basis of a concentric circles approach. The logic of this approach is straightforward. By strengthening cooperation within ASEAN, the group can engage more effectively in the wider regional grouping; in turn, the wider regional grouping can further promote ASEAN's interests and strengthen its participation at the global, multilateral level. This approach provided the justification for ASEAN to take an active part in the development of the Asia-Pacific Economic Cooperation (APEC) group.

Initially, ASEAN was worried that APEC would dilute ASEAN. There were two concerns: that the interests of developing members would be overruled by those of advanced members and that ASEAN would be overwhelmed by the more ambitious APEC agenda. The prevailing wisdom then was that beyond ASEAN regionalism the region's interest was global. However, ASEAN countries have recognised that there is increased economic interdependence in the emerging Asia Pacific region, and this has led them to accept the need for more structured economic cooperation within this wider region. Regionalisation should be followed by a kind of regionalism – Asia Pacific regionalism – which could both increase the gains from economic interdependence and prevent political tensions from arising due to increased economic transactions. To ensure that ASEAN's interests are represented in APEC, the APEC meeting is held in an ASEAN country every other year. This is why ASEAN is regarded as APEC's co-pilot.

An ASEAN caucus was formed in the early years of APEC, but after a while it was no longer seen as effective. ASEAN members could not decide amongst themselves who should host the APEC secretariat. In 1994, when Indonesia was the chair of APEC, some ASEAN heads of state wanted to organise an ASEAN summit prior to the APEC summit in order to develop a common stance on some issues. President Soeharto argued against this, saying that such a summit could produce the impression that ASEAN countries were ganging up against other APEC members. Some tensions arose as Indonesia and Malaysia – and to some extent Thailand – expressed reservations about the APEC Bogor Declaration. This development was a major test case for

ASEAN's concentric circles approach. It was overcome at the next APEC summit as the modality for achieving the Bogor goals was clarified in the so-called Osaka Action Agenda.

In late 1990 Malaysia's Prime Minister Mahathir expressed his unhappiness with US moves to form the North American Free Trade Area by proposing the creation of an East Asian Economic Grouping. ASEAN later modified this proposal, suggesting the creation of an East Asian Economic Caucus to act as a caucus within APEC. However, the economic caucus did not get off the ground. In 1997, the Asian financial crisis provided the impetus for the ASEAN+3 process. East Asian countries felt that the United States could not be relied upon in a financial crisis and that they would have to establish their own self-help mechanisms for financial cooperation. This was the basis for an emerging East Asian regionalism. Australia showed an interest in the development of a regional financial architecture and made financial pledges to assist the crisis-hit countries. However, Australia was excluded from the ASEAN+3 process because Mahathir did not accept that Australia was an East Asian country.

There are several grounds for the idea of an East Asian regional arrangement. One is that there should be an effective 'Asian' voice in global affairs. Another, advanced by the late Saburo Okita, is that East Asia should be placed on a more equal footing with the United States so as to effectively manage trans-Pacific relations in a way similar to that of Europe and the United States in the trans-Atlantic relationship. It can, thus, be argued that the development of an East Asian regional identity would help strengthen APEC. An East Asian regional arrangement, the East Asian Community, therefore, should be seen as a critical 'circle' between ASEAN and APEC, especially from a strategic point of view (Ahn 2003; Wanandi 2004).

In reality, the way in which an AEC and an East Asian Economic Community fit together will depend on how each of the two processes unfolds and how they interact with each other. While it has never been explicitly stated, there is also ASEAN's worry that it would be diluted by a wider East Asian regional arrangement, because China and Japan are much bigger countries and economies than ASEAN as a whole. There are different routes to creating an East Asia Economic Community (Soesastro 2001). One is through the establishment of an East Asia Free Trade Area. Another is through the formation of a free trade area in Northeast Asia that is subsequently amalgamated with the ASEAN Free Trade Area. A third is through the amalgamation of three separate ASEAN+1 agreements – the ASEAN–China, ASEAN–Japan and ASEAN–Korea agreements. A fourth is based on the notion of monetary regionalism and would focus on financial cooperation and integration.

The three separate ASEAN+1 arrangements are currently being developed. It remains to be seen whether such separate arrangements will become building blocks for the East Asian Economic Community. ASEAN will play a critical role here, and it can perform this role if it can realise the AEC much earlier than the 2020 target date.

Towards an ASEAN Economic Community

The AEC concept was contained in the ASEAN Vision 2020 launched at the 1997 ASEAN summit and has been formally on ASEAN's agenda since the 2002 ASEAN summit, when it was proposed by Goh Chok Tong, the Singapore Prime Minister.

Hew and Soesastro (2003) have described various ideas for deepening ASEAN economic integration towards an AEC. There have been two main approaches: an AEC as an 'FTA-plus' and an AEC as a 'common market minus'. The latter could be more liberalising than the former, and would have the additional advantage that it would include the explicit formulation of some kind of 'negative list' of temporary exclusions that could be brought under the umbrella of the integration project. In addition, there is the McKinsey study on ASEAN competitiveness, which suggested that turning ASEAN into a true single market would boost its competitiveness (Schwarz and Villinger 2004 forthcoming).

The ASEAN economic ministers have created a high-level task force of senior officials to develop recommendations on deepening ASEAN economic integration. At the 2003 Bali summit, the ASEAN leaders endorsed the task force's recommendations.

In the Bali Concord II agreement, the ASEAN leaders stated that the AEC would establish ASEAN as a single market and production base, turning the diversity that characterises the region into opportunities for business complementarity and making ASEAN a more dynamic and stronger segment of the global supply chain. They further suggested that, in moving towards the AEC, ASEAN would institute new mechanisms and measures to strengthen the implementation of its existing economic initiatives; accelerate regional integration in priority sectors; facilitate the movement of business persons, skilled labour and talent; and strengthen the institutional mechanisms of ASEAN, including improving the existing ASEAN dispute settlement mechanisms to ensure the expeditious and legally binding resolution of economic disputes.

The task force's recommendations are seen as a first step towards the realisation of the AEC. There are five sets of recommendations. The first concerns the strengthening of cooperation under existing economic cooperation initiatives in the areas of trade in goods, including customs

and standards, trade in services, investment, intellectual property rights, and capital mobility. The second proposes new initiatives and measures in the 11 priority sectors for integration (wood-based products, rubber-based products, agriculture-based products, fisheries, textiles and apparels, automotives, electronics, air travel, tourism, health care, and e-ASEAN). The third relates to institutional strengthening, including the establishment of an effective dispute settlement system. The fourth proposes the establishment of an outreach program to give the business/investor community and public sector agencies a better appreciation and understanding of ASEAN economic issues. The fifth deals with development and technical cooperation to address the development divide and to accelerate the economic integration of newer ASEAN members.

Various studies on the AEC and proposals as to how to realise it have pointed to a number of measures that need to be taken. The high-level task force has also identified such measures. However, there is concern that, in view of its serious institutional deficit, ASEAN's agenda could easily be overloaded. Institutional strengthening should, therefore, be an integral part of the integration project. However, it is important that ASEAN's agenda be kept at a manageable level. It will be useful to identify the core elements of integration, and there is a need to make efforts to put the core elements in place, ideally much earlier than the 2020 target date. New initiatives should be kept at a minimum and most should focus on institutional strengthening.

The task force's recommendation to accelerate the integration of priority sectors was inspired by the McKinsey ASEAN competitiveness study (Schwartz and Villinger 2004 forthcoming). Schwartz and Villinger argued that reforms across the entire economy are politically difficult as well as risky but that a well-targeted approach focused on sectors would show the benefits of integration over time and could generate political support for extending the program. They suggested that reform should begin in two sectors: consumer products and electronics. ASEAN's selection of 11 sectors was more ambitious. The task force suggested that ASEAN should develop a road map for each of the 11 sectors and that the private sector should be actively involved in implementation, beginning in 2004. No road map had been produced at the time of writing.

Schwartz and Villinger proposed that four initiatives should be pursued in each priority sector. First, non-tariff barriers should be eliminated. This should include efforts to increase the efficiency of customs, harmonise or mutually recognise product and technical regulations, and remove duplication in testing and licensing procedures. Second, tariff reform should be enhanced. This should include the elimination of internal tariffs as well as closer alignment of each

member country's external tariffs. Third, a level playing field for capital should be created by eliminating restrictions on cross-border investments within ASEAN and by introducing an ASEAN-wide competition policy. Fourth, regional collaboration should be improved. This should include the promotion of an easier flow of skilled labour across the region and better mechanisms to provide development and technical assistance to the newer ASEAN members.

At the 2004 summit in Vientiane, ASEAN will produce a plan of action to 2010. It remains to be seen whether it can agree to have the core elements of the AEC in place by 2010. Failure to do so will make the exercise no longer meaningful: competitive pressures from China are already strongly felt, and soon this will also be the case for India. In addition, ASEAN is engaged in a number of FTA negotiations. For example, the ASEAN–China FTA will be completed by 2015, before the target date for the AEC. Therefore, ASEAN must formulate an agenda that focuses on the essentials and must implement it in the shortest time possible.

Whither ASEAN+3 and the East Asian Economic Community?

In terms of promoting an East Asia region-wide cooperation agenda and a regional arrangement, the ASEAN+3 process saw the strongest development from 1998 to 2001. In 1998 the East Asia Vision Group was established. In 1999, ASEAN+3 leaders produced a 'Joint Statement on East Asian Cooperation'. In 2000, they established the East Asia Study Group to assess the recommendations of the East Asia Vision Group. They also agreed to explore the idea of an East Asian summit. In 2001 the ASEAN+3 leaders endorsed the idea of an East Asian Economic Community.

In 2001, the ASEAN+3 process was already overshadowed by the ASEAN–China initiative towards a comprehensive economic cooperation agreement, which includes a free trade agreement (FTA) and which was signed in 2002. In 2003 ASEAN and Japan signed a 'Framework for Comprehensive Economic Partnership'. At the ASEAN+Korea summit, the government of South Korea made a commitment to develop a comprehensive partnership with ASEAN. The leaders asked ministers to discuss the possibility of establishing a free trade area between ASEAN and South Korea.

These developments suggest that at the highest policy level the emphasis of ASEAN+3 cooperation has moved from region-wide efforts to separate ASEAN+1 agreements. The focus of these agreements is trade. However, there have been no efforts to promote region-wide trade cooperation. At their ASEAN+3 meeting in Phnom Penh in September 2003, the economic

ministers noted the initiatives taken to establish the East Asia Forum and the East Asia think-tank meeting, but they suggested that the East Asia Free Trade Area is a long-term goal that should be evolutionary, taking into account the different stages of social, economic and cultural development in East Asian countries.

The ASEAN+3 economic ministers were rather modest in their expectations. Indeed the 2003 ASEAN+3 summit was a non-event. The chairman's statement on East Asian cooperation contained nothing significant. It mainly highlighted the initiatives and progress in each of the ASEAN+1 negotiations, including between ASEAN and India. In the trade area, there has been further fragmentation as some ASEAN countries eagerly negotiate bilateral FTAs with China, Japan and South Korea.

There has been some further progress in East Asian financial cooperation. In August 2003, ASEAN+3 finance ministers met in Manila and agreed to strengthen East Asia financial cooperation. They noted that the number of bilateral swap arrangements (BSAs) had doubled from six to 12, and that the size of the network had increased from US\$17 billion to US\$31.5 billion. By the end of 2003, 16 such agreements had been concluded, and the total amount reached US\$35.5 billion.

The finance ministers also agreed to strengthen the current peer review process by implementing the recommendations made by the ASEAN+3 Study Group to Examine Ways of Enhancing the Effectiveness of Economic Reviews and Policy Dialogues. In addition, they agreed to set up the ASEAN+3 Finance Cooperation Fund to support ongoing economic review and policy dialogue. The fund would complement efforts to enhance the effectiveness of economic surveillance in support of the Chiang Mai Initiative. It would be administered by the ASEAN secretariat.

Furthermore, the finance ministers agreed to intensify their efforts to develop regional bond markets. This will further strengthen financial systems by better utilising the aggregate savings in the region and minimising the risk of maturity and currency mismatches. The finance ministers have established voluntary working groups to further discuss a range of key issues crucial to further development of the domestic and regional bond markets – for example, securitisation, credit guarantee, promotion of local currency denominated bonds, credit rating, and foreign exchange transactions and settlement issues.

It remains to be seen whether financial cooperation could counteract the fragmentation in the area of trade cooperation (Soesastro 2003). Perhaps the biggest problem for the ASEAN+3 process is that it may have lost momentum. Amongst the leaders there are no longer champions

of the process like Kim Dae Jung, the former South Korean President. The sense of urgency in developing financial cooperation mechanisms seems to have weakened as well. In addition, the vision for East Asia developed by the East Asia Vision Group appears to have been truncated by the officials in the East Asia Study Group. Moreover, it is not immediately obvious who would be able to bring vitality and dynamism back into the ASEAN+3 process.

A concluding note

Perhaps ASEAN could play a role in revitalising the ASEAN+3 process if it could bring in its three partners from the north – China, Japan and South Korea – to help in the process of deepening ASEAN economic integration towards an AEC. Adopting the ASEAN+1 strategy appears to be the most feasible option. It is unavoidable that each such bilateral agreement will be tailor-made. This is exactly why it may be difficult to amalgamate them into a region-wide agreement at a later stage. Having this in mind, the PECC Trade Forum has proposed some kind of ‘APEC Common Understanding on Regional Trading Arrangements’ that sets out guidelines to ensure that FTAs in the APEC region contribute to the achievements of APEC’s objectives. East Asian countries should seriously take these guidelines into consideration when establishing bilateral or sub-regional FTAs. The elements of this ‘common understanding’ include the following.

1. *Relation to the ‘pathfinder’ concept.*

FTAs involving APEC economies should be fully consistent with APEC objectives and principles, and participation in the network of FTAs within the APEC region should, over time, become open to all APEC economies.

2. *Conformity with APEC liberalisation objectives.*

Liberalisation and facilitation provisions of FTAs between economies must be extended to all APEC economies by the Bogor target dates. The timetable for liberalisation should be consistent with the Bogor dates. Most favoured nation (MFN) liberalisation should proceed in parallel with the implementation of FTAs. All MFN barriers should be reduced to moderate levels as soon as possible. Elimination of peak tariffs and tariff escalation must be given priority.

3. *Conformity with APEC principles in the Osaka Action Agenda.*

First, concessions provided within FTAs should be made available to all APEC members as soon as circumstances allow, but no later than the Bogor target dates. Second, people should

recognise that consistency with GATT Article XXIV and GATS Article V is a necessary but not sufficient condition for ensuring that FTAs contribute to the achievement of APEC objectives. Third, FTAs should cover trade in both goods and services and should cover all sectors, with sensitive sectors being liberalised according to a slower timetable. Fourth, peer review should be allowed before the FTAs are finally concluded. Fifth, peer review should provide an opportunity for discussion of any problems that FTAs under review may be causing for other APEC members and of ways of resolving those problems.

4. *Consistency with other APEC principles.*

Where relevant, provisions in FTAs should be linked to the specific sets of principles that APEC members have adopted (for example, non-binding investment principles and principles on competition and regulatory reform).

5. *Promotion of convergence and minimisation of 'spaghetti bowl' problems.*

First, rules of origin should be as straightforward as possible; they should be transparent, clear and consistent, and should not impose unnecessary compliance costs. Second, countries should be encouraged to adopt harmonised provisions across FTAs. This could be achieved by, whenever possible, making use of international standards and APEC-wide agreements and processes.

6. *Use of 'best practice' guidelines.*

Liberalisation of both goods and services within FTAs should be made progressive and automatic.

7. *Cognisance of the development dimension.*

FTAs should allow for the provision of assistance in capacity building.

To provide greater assurance that FTAs in East Asia could lead to a region-wide arrangement, leaders of ASEAN+3 countries should agree to immediately launch a systematic effort to develop region-wide guidelines that eventually will be adopted as the basis of an East Asia Free Trade Area. This is where they should invest their energy. The formation of bilateral FTAs is a misguided effort.

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