ASEAN Economic Cooperation for the 1990s

A report prepared for the ASEAN Standing Committee

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Foreword

We are currently at an important historical watershed in the history of ASEAN. The need to move forward in economic cooperation has never been greater. The requirements of economic development in the individual ASEAN countries, coupled with the changing nature of the international marketplace, are highlighting the benefits and opportunities of increased economic integration and harmonization. And perhaps more than ever before, the will to achieve the goals articulated by the ASEAN Founding Fathers has never been greater.

As we begin to chart a new course for ASEAN economic cooperation in the 1990s, a great many fresh ideas and recommendations are necessary to ensure the adoption of a thorough, pragmatic, and effective program of action. Hence, at the request of the ASEAN Standing Committee, I have brought together a team of prominent ASEAN statesmen and experts to consider in-depth the best course for ASEAN. The drafted results of their endeavors were submitted to the ASEAN Senior Economic Officials Meeting in late September, and were subsequently discussed at the Twenty-third ASEAN Economic Ministers Meeting in October. It is hoped that the recommendations of the study team will serve as useful input to the Fourth ASEAN Summit to be held in Singapore in January 1992.

I would like to thank the study team for their diligent and thoughtful work, which was accomplished over a very short period of time. In particular, I am grateful to the Chairman of the Advisory Committee, Dr. Amnuay Viravan, and the Coordinator of the researchers, Dr. Seiji Naya. Also, great appreciation is due to the United Nations Development Programme for their financial assistance.

Rusli Noor
Secretary-General
Preface

In preparation for the upcoming Fourth Summit in Singapore, the Secretary-General of the ASEAN Secretariat was requested by the ASEAN Standing Committee to organize a study that would yield dynamic and vital ideas for economic cooperation for the future. The present study, "ASEAN Economic Cooperation in the 1990s," is the result of the combined efforts of the ASEAN Secretariat, an Advisory Committee, and a group of ASEAN experts.

The preparatory work for the study began in May 1991, when the ASEAN Secretariat, in consultation with experts and government officials, put together a team of advisors and researchers. The Advisory Committee was comprised of Dr. Amnuay Viravan (Chairman), Dato Paduka Malai Ali Othman, Professor Dr. Ir. Mohamad Sadli, Tan Sri Dato R.V. Navaratnam, Senator Vicente Paterno, and Ambassador Tommy Koh; and the research team members included Professor Seiji Naya (coordinator), Professor Mohamed Ariff, Dr. Chng Meng Kng, Dr. Ponciano Intal, Jr., Professor Augustine Tan, Professor Vithit Muntarbhorn, Dr. Anthony T.H. Chin (contributor), Dr. Somsak Tambunlertchai (contributor), Dr. Pearl Imada (associate), and Dr. Michael G. Plummer (associate). The First Joint Meeting was held in Bangkok in July to lay the groundwork, discuss research topics, and give assignments to the research team members. The Second Joint Meeting took place in Singapore, where the tentative findings and recommendations of the research team were debated and revised. A draft of the Overview of Recommendations was submitted to the Senior Economic Officials September 29, in order that the results could be made available for discussion at the Twenty-third ASEAN Economic Ministers meeting in October.

The main results of these endeavors are found in the present report, including a summary of the recommendations and an overview of the study's findings, as well as the background papers prepared by the research team, which served as a basis for the findings and recommendations of the study. In sum, the report stresses the need for ASEAN to
enhance its regional cooperation efforts in a rapidly-changing international economic environment. To accomplish this, the study recommends that ASEAN move forward in its ASEAN economic cooperation programs by eventually creating an "ASEAN Free Trade Area Plus" arrangement, which will include not only intra-regional free trade but also other areas of cooperation, such as non-tariff barriers, product and technical harmonization, and macroeconomic cooperation and consultation. It also urges ASEAN to maximize its clout in international fora by strengthening cooperation and working together. An ASEAN Framework Agreement would enhance the effectiveness of these programs and would be an important catalyst for economic cooperation in the future. By moving in this direction, ASEAN will be able to achieve the goals of its Founding Fathers to promote regional harmony and welfare to the general satisfaction of all.

This study is intended to be a first step in looking for alternative ways to improve regional integration efforts. In the next few years, it will be necessary to undertake further studies in choosing the precise means and characteristics of an "ASEAN Free Trade Area Plus" and an ASEAN Framework Agreement.

We are grateful to a number of organizations and individuals for this study. Secretary-General Rusli Noor provided excellent guidance and devoted considerable time and effort to ensuring the successful completion of the study. Moreover, the contributions of his staff, most notably Mr. Victor Gosiengfiao and Mr. Johari Achee, were invaluable. We would also like to thank especially the United Nations Development Programme, in particular Mr. K.G. Singh, for financial contributions.
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Rationale

To enhance the value of ASEAN to its member countries in the 1990s and beyond, ASEAN must strive to go beyond the pursuit of regional peacekeeping and political stability into greater economic cooperation. Internal developments within ASEAN (such as increasing industrialization levels in all member countries and far-reaching domestic economic reforms, including the movement towards more liberal private-sector oriented economies and the unilateral reduction of trade and investment barriers) have made closer economic cooperation easier now than previously. Dramatic changes in the international situation have made expanded ASEAN economic cooperation imperative.

Approach

There is a growing convergence of views within ASEAN as to the viability of enhanced ASEAN economic integration. This study seeks to build upon and extend this convergence. It believes that ASEAN economic cooperation should move forward on a broad front. The benefits of greater intra-ASEAN economic cooperation are potentially large. Studies have shown that the creation of a free trade area would be beneficial to ASEAN countries, and the dynamic effects, stemming from economies of scale, resource pooling, etc., should be highly significant.

A framework for ASEAN cooperation. To create a greater sense of an ASEAN economic community, ASEAN needs a general cooperative framework to guide its vision, as well as specific areas of endeavor to operationalize that vision. Both can be implemented in linked step within an agreed time frame. The Fourth Summit may direct ASEAN to carry out a work program for studying and ultimately giving recommendations as to the essential features, goals, direction, components and timetable for expanded ASEAN economic integration and harmonization. Findings and recommendations
arising therefrom would be submitted to the Fifth Summit, presumably to be held in 1994. These preparations are needed to work out the detailed substance and the institutional modalities most effective and suitable for implementing ASEAN economic cooperation. These could take at first the form of a broad and flexible framework agreement and subsequently the form of an economic treaty. Moreover, the stages through which the ASEAN economic community would be established would be agreed to as part of the package. Also, the timeframe for these stages would have to be laid out, for example, a rapid (5-8 years), moderate (8-10 years) or gradual (11-15 years) transitional phase may be adopted. Alternatively, if further preparatory work is deemed necessary, the timeframe commitment could be postponed until a stipulated date. Institutional changes such as the strengthening of the ASEAN Secretariat to include technical and monitoring capabilities will also have to be considered.

An ASEAN Free Trade Area. As a concrete step towards the creation of an ASEAN economic community, we recommend that the Fourth Summit give an endorsement in principle to an ASEAN Free Trade Area (AFTA). Such a free trade area could be realized through the strengthening of existing ASEAN trade liberalization programs such as the ASEAN Preferential Trading Arrangement (PTA) and the newly developed Common Effective Preferential Tariff (CEPT) scheme. The work program to determine the coverage, sequencing, and special considerations for some countries (decalage) should also be established in preparation for the Fifth Summit. In addition, it will be important to specify a workable scheme to determine product origin. Some consideration should be given to using a "basic materials list" and a process approach in addition to a lower content requirement. A well-defined and transparent transition process would eliminate uncertainty and enable the private sector to accurately plan for free trade.

However, ASEAN economic cooperation should go beyond a free trade agreement to include non-border areas of cooperation to support and facilitate the creation of a free trade area. Recent agreements, e.g. U.S.-Canada Free Trade Area, show that it is not enough to look only at tariff and non-tariff barriers when forming a free trade area. Other non-border measures, such as investment policies, product and technical harmonization, and macroeconomic cooperation and consultation, are complementary and in many cases necessary to create a viable free trade area. For example, it will be important to look at how product standards and regulations affect trade and investment. Specific areas where harmoniza-
Summarization can facilitate intra-ASEAN trade should be identified. The necessary components of a "free trade area plus" will have to be determined through careful analysis before a final prototype can be selected.

**Industrial cooperation.** Industrial cooperation should be expanded and linked more closely with trade cooperation. As a first step, it will be important to identify and begin to remove barriers to direct foreign investment. The implications of offering national treatment to investors from ASEAN countries should be examined. If the CEPT approach to trade liberalization is chosen, national treatment can first be conferred on firms in the CEPT sectors. Additionally, regionally-linked projects in "growth triangles" may also be considered for national treatment. As greater trade liberalization makes ASEAN a more integrated investment area, consultation on and harmonization of investment incentives and regulations will prove to be useful. Selective liberalization of the movement of factor services should be explored to catalyze greater intra-regional trade and investment.

**An "ASEAN Equity Fund."** More specifically, ASEAN may consider giving its approval to the establishment of an "ASEAN Equity Fund," in which the private sectors in all ASEAN countries could participate as a source of risk and venture capital in the region. Such a fund would spur new opportunities, create ASEAN-wide investments both large- and/or small-scale, and facilitate the twin ASEAN goals of pooling resources and markets. The Fund would complement existing institutions such as the ASEAN Finance Corporation and existing industrial programs such as the ASEAN Industrial Joint Ventures (AIJV). The ASEAN Equity Fund could be funded internally by the private sector in ASEAN countries, with contributions also coming from Northeast Asia and elsewhere. Investments with various combinations of ASEAN and foreign capital would be allowed, subject to the constraint that production be located in ASEAN countries. Additional incentives may be considered by ASEAN such as providing national treatment to firms under this Fund.

**Macroeconomic consultation.** Increasing intra-ASEAN economic linkages underline the need for greater macroeconomic consultation, cooperation, and harmonization, including monetary and fiscal policies, as well as discussions to address external commercial policy issues. An excellent forum for these discussions would be a regular meeting of the ASEAN Economic Ministers to coordinate and consult regarding macroeconomic policies, with the possible attendance of the member state central bankers.
The ASEAN Macroeconomic Outlook (AMO) project can provide a useful base and platform for such activities.

*External economic relations.* The major fruits of ASEAN economic cooperation may well lie in its external relations. The external strength of ASEAN, however, is a function of its internal cohesiveness. With growing internal linkages, ASEAN can play a more active and effective role internationally and in larger regional groupings as a single bargaining unit. ASEAN’s stake in the Pacific economy is growing, making a more active role in Asia Pacific Economic Cooperation (APEC) imperative. APEC can be used as a forum to address problems emerging from the increased economic interactions and interdependence in the region. The East Asian Economic Caucus will also provide an excellent opportunity for ASEAN to work as a unit to its benefit.

The formation of a Trade and Investment Cooperation Committee (TICC) under the ASEAN-U.S. Initiative (AUI) is a useful model for expanding ASEAN’s external economic relations. Similar cooperative mechanisms can be set up under an ASEAN-Japan or ASEAN-Korea Initiative. Alternatively, ASEAN could expand the scope of the Post Ministerial Conferences (PMC) on economic issues. The role of the ASEAN Economic Ministers in external economic relations would have to be enhanced.
PART ONE

ASEAN Economic Cooperation for the 1990s:
Main Report
ASEAN Economic Cooperation for the 1990s

I. A New Impetus for ASEAN Economic Cooperation

ASEAN needs to renew its vision in a rapidly-changing global economic environment. Both internal and external forces will not allow ASEAN to stand still. Its internationally-respected achievements in the areas of politics and diplomacy have strengthened cohesion within ASEAN and increased confidence in its abilities to play a key role in global matters. However, the Cold War has ended; as a result, political and strategic concerns have diminished while economic issues now occupy center stage. Hence, in the 1990s and beyond, ASEAN's usefulness in promoting the social welfare of its member nations will be increasingly seen in terms of its successes in regional economic harmonization and integration. The goal of the present study is to explore and highlight the opportunities and imperatives associated with increased ASEAN economic harmonization and integration, and to give recommendations, insights, and ideas in creating an ASEAN economic community for the future.

External and Internal Dimensions

Eastern European and other centrally planned economies are being transformed into market economies. They are now actively implementing market reform measures to increase the competitiveness of their economies, thereby not only creating opportunities for Asia but posing competitive threats as well. At the same time, several new developments in global negotiations could significantly change the current trading environment in the 1990s. As evidenced by the move of the European Community (EC) to form a single unified market in 1992 and by the likely formation of a North American Free Trade Area, regional trade relationships have become more important. To face these challenges, closer economic cooperation among ASEAN member countries is imperative. Greater ASEAN economic cooperation can help to keep global markets open as well as enhance the attractiveness of the ASEAN market. There are many attendant benefits
and opportunities resulting from a more tightly-integrated ASEAN economic community that will spur economic growth, development, and prosperity throughout the entire region.

With far-reaching domestic economic reform programs in all ASEAN countries and the movement toward more liberal private-sector-oriented economies, the ASEAN countries will find closer economic cooperation easier now than previously. Increasing industrialization levels of all countries and the unilateral reduction of barriers to trade and investment are facilitating greater economic integration. With rapid industrialization, the expanding exports of manufactured goods would constitute the main thrust of the flourishing regional economic development. Few would doubt that ASEAN is one of the most exciting regions in the world, and prospects of higher levels of economic cooperation and harmony are enhancing this image.

Although the phenomenal economic success in ASEAN member-states cannot be directly attributed to ASEAN economic cooperation per se, ASEAN as a regional organization has progressed impressively and recorded significant successes in its economic cooperation efforts. Additionally, the effects that ASEAN as an entity has had on peace, goodwill, and stability in the region have been extremely important for its sustained economic development. Had ASEAN economic cooperation been overly ambitious at a time when the member states were not yet ready for it, the result might have been disastrous. Economic cooperation to date has provided ASEAN with an easy, step-by-step way in which to proceed, and has laid the framework for future cooperation. Its twenty-four years of cooperation have been a valuable learning process conducive to greater cooperation.

The private sectors in the individual countries have been pressing for an acceleration of the pace of ASEAN cooperation and are looking forward to taking advantage of the new opportunities that will accompany closer cooperation. As ASEAN becomes a more integrated area, foreign investors will also evaluate ASEAN as a more attractive place. Overall, the private sector has been a vocal and dedicated protagonist of a new, stronger ASEAN.

An ASEAN "Free Trade Area Plus"

Thus, it is apparent that the time has come for a bold, new approach to ASEAN economic cooperation, a concept whose importance and potential has been recognized at the highest levels of government in the region. But
what should be the characteristics and direction of closer ASEAN economic cooperation?

For the first time, internal and external economic conditions are highlighting the opportunities and imperatives of an ASEAN free trade area. Support for this is no longer coming just from academia and the private sector; ASEAN ministers are now supportive of the idea in principle. Conditions are now right for the creation of a free trade area. The groundwork for such a move is already in place due to ASEAN’s experiences with the ASEAN Preferential Trading Arrangement, but the formation of a free trade area in ASEAN will require improving the present tools used to reduce intra-ASEAN trade barriers and strengthening ASEAN’s institutions.

It is not enough, however, to reduce tariff and non-tariff barriers. ASEAN will have to go beyond a traditional free trade area, which, strictly defined, only ensures no tariffs on intra-regional trade. Other regional groupings have also recognized that a successful and meaningful regional economic relationship depends on harmonization as well as integration measures. International economic interaction is affected not only by border controls but also by domestic economic policies of the countries involved. At the Uruguay Round of GATT negotiations, the emphasis for the first time was no longer on reducing tariff barriers but rather on non-tariff barriers and non-border measures such as trade-related investment measures, trade-related intellectual property rights, etc. Moreover, the U.S.-Canada and the Australia-New Zealand agreements have gone well beyond the regional freeing of tariffs and into other areas that are integration-in-nature, such as non-tariff barriers, services, product harmonization, mutual recognition principles, factor movements, external relations, and other forms of joint cooperation. The European Free Trade Association (EFTA) excludes agriculture; even the EC, through various subsidies and regulations, has hitherto protected individual country markets. ASEAN will similarly have to find its own brand of integration uniquely suitable to its circumstances.

Additionally, ASEAN integration should include “common-needs oriented” topics, i.e., those that are not integration-in-nature per se but which reflect common concerns or requirements of the ASEAN region, for example, in terms of human resource development, technology transfer, environmental concerns, illicit drugs, etc. Furthermore, despite progress made in recent years, there remain disparities in levels of economic development and industrialization and in the degree of protection pro-
vided to domestic industries. Any comprehensive plan for ASEAN integration will thus have to consider these issues.

In establishing an "ASEAN Free Trade Area Plus," it is clear that extensive discussions and negotiations will be required. ASEAN will perforce have to create new institutions and vehicles for communication, or at least strengthen and otherwise modify existing ones. These changes will only be feasible if there exists the political will to move forward. Dedication to strengthening the ASEAN vision and giving it direction and purpose will be a prerequisite to real, effective progress in regional economic integration and harmonization. Only then will we see the emergence of what can be considered a truly integrated ASEAN economic community.

**Topical Outline of the Study**

The issues involved in the creation of an ASEAN Free Trade Area Plus need to be closely inspected, and the costs and benefits delicately weighed. Towards this end, this study conducts a comprehensive assessment of ASEAN economic cooperation and provides recommendations for the future direction and new modalities of economic cooperation. It covers four principal areas that are inter-related: (1) trade and industrial cooperation, (2) internal policy coordination, (3) external economic relations, and (4) an ASEAN Framework Agreement. Its goal is to assist ASEAN decision-makers in proposing new measures for ASEAN economic cooperation and to explore the components of an "ASEAN Free Trade Area Plus." In each of the four areas, the sections first review past performance and problems in the relevant areas and then make recommendations on how these can be improved or replaced by new modalities of cooperation. The most important goal in this regard is to lay out more clearly the path to economic harmonization and integration upon which ASEAN should tread.

**Recommended Plan of Action**

In moving toward the creation of an "ASEAN Free Trade Area Plus" the following plan of action is proposed. First, at the Fourth ASEAN Summit in January 1992, an endorsement in principle to an ASEAN free trade area should be reached. Second, the Fourth Summit should commit itself to studying and ultimately giving recommendations as to the essential features, goals, direction, components, and timetable, with a view to submitting the findings and recommendations to the Fifth Summit, presumably to be held in 1994. At the Fifth Summit, the key decision to negotiate an ASEAN
Framework Agreement and create an integrated ASEAN economic community, with the free trade area and other forms of economic integration and cooperation at its core, would be made. Moreover, the stages through which the ASEAN economic community would be established should be agreed to as part of the package. Also, the timeframe for these stages would have to be laid out, for example, a rapid (5-8 years), moderate (8-10 years) or gradual (11-15 years) transitional phase may be adopted, or, if further preparatory work is deemed necessary, the timeframe commitment could be postponed until a stipulated date.

II. Trade and Industrial Cooperation

Trade liberalization and industrialization schemes to increase market sharing and resource pooling have been the core of ASEAN economic cooperation. Progress in this area has been steady but intentionally gradual beginning with the Second Summit in the mid-1970s. In the area of trade, the ASEAN Preferential Trading Arrangements Agreement (PTA) sought to increase intra-regional trade through preferential reductions in tariff rates first by using a product-by-product approach and then through a more effective across-the-board method. Although it is generally agreed that little trade has actually been created under the PTA, the process and mechanisms for greater future cooperation have been established.

The newly-proposed Common Effective Preferential Tariff (CEPT) is a promising, innovative approach to trade liberalization, as it provides a means for harmonizing internal tariff rates. The basic idea of the CEPT is that a common internal tariff rate will be set for selected ASEAN products. This common rate will represent a maximum internal tariff and will be gradually reduced to zero. No exclusion list will be allowed, although preferences will be accorded to selected industries. The CEPT is not meant to replace the PTA or the AIJV but is considered to be an extension of industrial cooperation. The product-by-product approach recommended in the original proposal may, however, limit its effectiveness.

A similar tale can be told about industrial cooperation. Presently, there are only a few actual working projects under these programs, and the investment created has been minimal. Nonetheless, the shift in emphasis away from the large-scale government approach in the ASEAN Industrial Projects (AIP) into the more private-sector based ASEAN Industrial Joint Ventures (AIJV) and the emergence of brand-to-brand complementation in
the ASEAN Industrial Complementation (AIC) are important steps forward. The Third Summit increased the allowable equity share for foreigners from 49 to 60 percent and increased the margin of preference for AIJV-status products to 90 percent from an original 50 percent. Problems remain, however, and these include cumbersome procedures, monitoring and implementation difficulties, and insufficient knowledge in the private sector regarding the program.

In short, ASEAN trade and industrial cooperation programs have successfully transformed themselves to incorporate a more practical, market-based approach. Yet the direct impact of these programs has been limited. The explanation lies primarily in inherent structural rigidities and in an understanding by the ASEAN leaders that one can only go as fast as domestic economic conditions would allow.

The time has come for ASEAN to move toward integration and harmonization of their economies. But what form should integration in trade and investment take in ASEAN? As mentioned in the introduction, however, the textbook descriptions of preferential trading areas and free trade areas are no longer applicable to real world situations. The increasing importance of service sector trade, factor flows, and investment must be addressed in any effective trading arrangement. Also, disparities in income levels and national sensitivities about specific sectors such as agriculture have to be considered. Therefore, we recommend the formation of an ASEAN Free Trade Area Plus which will build on ASEAN’s past experience and actively promote trade and investment in the region.

**Why Create an ASEAN Free Trade Area?**

External and domestic changes underscore the need for closer market-sharing among the ASEAN countries, a goal explicitly built into ASEAN declarations. The increasing fragmentation of the world economy, the competitive pressures from other regions in the world, and the strong economic performance in recent years of ASEAN countries provide the motivating forces for enhanced ASEAN integration. Not only will harmonization and integration of the ASEAN economies lead to a stable, regional, dynamic market from which ASEAN countries will benefit; it will also allow for a more competitive regional division of labor and resource pooling, leading to greater economies of scale and an important impetus to direct foreign investment.

Some recent findings indicate that the removal of intra-regional tariffs would result in a significant increase in intra-ASEAN trade and that the
increase in trade will be fairly distributed. Given the dynamic changes occurring in ASEAN, however, any attempt to measure direct effects would likely come up with underestimates. For example, with the rapid increase in trade of manufactured goods in the region, the scope for expansion of intra-industry trade, which has been an important element in expanding EC trade, is large. The positive effect of achieving economies of scale and increasing efficiency in production are also not easily measured. A well-defined program of intra-ASEAN cooperation will further improve the benefits of a free trade by, among others, strengthening complementarities, reducing infrastructural and financial bottlenecks, and improving administrative mechanisms supportive of trade.

Steps Toward an ASEAN Free Trade Area

An ASEAN Free Trade Area Plus would start with an endorsement at the Fourth ASEAN Summit for a free trade area through the gradual reduction and eventual elimination of intra-regional tariffs within a set schedule of, say, fifteen years. This endorsement would recognize the need for detailed studies and preparations to spell out the exact form, characteristics, scope, and mechanisms of the free trade area to be approved at the Fifth Summit. Similarly, several proposed non-tariff and non-border areas of cooperation which go beyond a free trade agreement will need closer examination before a final form can be selected. A policy decision at the Fourth Summit to create a free trade area at a later date will stimulate active preparation and ensure the success of the free trade area when it is adopted.

Specific areas that should be broadly identified for study include:

1. **Mechanisms.** The Fourth Summit could specify the means to achieve the free trade area. The use of the present framework of trade cooperation with some modifications is likely to be the most expedient choice, that is:

   - The schedule for deepening the present PTA should be expedited and the exclusion list firmed up before the Fifth Summit.
   - The CEPT scheme would be an attractive method to reduce tariff barriers if used on a broad sectoral or product grouping basis. As in the original Indonesian proposal for the CEPT, a maximum internal tariff rate (of about 20 percent) could be set initially and gradually phased down to zero over a predetermined period. All present PTA items can be merged into the CEPT framework. After a well-defined transition period (say, 15 years), all commodities would be covered and ASEAN will have achieved internal free trade.
2. **Sectoral sequencing.** The selection of product groups or sectors and the timeframe for liberalization should be predetermined to allow the private sector to best take advantage of the preferential rates. In particular, a well-defined and transparent transition process would eliminate uncertainty and enable the private sector to accurately plan for free trade. As this is one of the most sensitive tasks to be undertaken that will require careful study, the Fourth Summit could agree that a schedule be prepared for the Fifth Summit.

* Industries or product groupings where investment is likely to be important, such as in electronics, may be good areas in which to begin as they are likely to confer the largest gains.
* If no agreement can be reached for some extremely sensitive sectors such as agriculture, ASEAN may consider delaying its inclusion for a certain time period, as has been done in other successful free trade areas. EFTA, for example, does not cover trade in agricultural products.

3. **Décalage.** Décalage or "getting out of step" can be used to accommodate differences in levels of economic development. Although the last few decades have seen a significant closing of differences in the level of development and protection, the gaps are still large and must be considered. This technique has been used in the current PTA, as Indonesia and the Philippines were allowed a longer transitional period (7-year instead of 5 year) for the implementation of Third Summit agreements. Décalage can likewise be used to provide flexibility to the CEPT scheme.

* Selected industries in some member countries can be granted somewhat higher CEPT rates and/or somewhat slower reduction in the CEPT rates over a definite time period. Care should be taken, however, to ensure that this is not abused.

4. **Rules of origin.** The current ASEAN content requirement in the rules of origin is 50 percent, although it can be reduced to 35 percent on a case-by-case basis. COTT proposes the reduction of the content requirement to 35 percent across-the-board; the ASEAN-CCI recommends a drop to 20 percent initially, to be increased periodically until it goes back up to 50 percent after nine years. Rules of origin will be necessary to avoid trade deflection, where all goods flow through the port of entry with the lowest tariff. However, the rules of origin agreement needs to be as simple, liberal and expeditious as possible to minimize the transactions and administrative costs to the government and the private sector.
Main Report

* Determination of qualification under the rules of origin will have to be made quickly, suggesting the need for pre-approved standards and procedures and for a technical body to oversee and implement the rules.

* Special consideration should be made in extreme cases in order to avoid excessive trade deflection or any other effects which may inhibit the transition process.

* An ASEAN content requirement of 40 percent may be considered as a reasonable compromise between various suggestions.

* In addition to a moderate domestic content requirement of about 40 percent, a "process approach" can be used to provide additional flexibility, as has been done in EFTA. Following this example, the process criterion would require that products from non-ASEAN countries undergo sufficient processing within ASEAN. The degree of processing could be indicated by the difference between the tariff heading of the processed product and its unprocessed non-ASEAN component materials. Items in a "Basic Materials List" of goods not produced in ASEAN or produced below ASEAN's level of demand would be considered as produced in ASEAN provided that the materials undergo some processing in ASEAN. The process criterion, properly refined to take into account the uniqueness of commodities, is an attractive addition to the ASEAN content criterion because it allows for the granting of tariff preferences without ASEAN content certification as long as the products have been sufficiently processed in ASEAN. A complementary approach to the current ASEAN content requirement should be studied, and a workable set of parameters should be prepared for implementation in ASEAN.

5. Non-tariff barriers. Non-tariff barriers to trade must be reduced. As effective tariff rates are progressively reduced, non-tariff barriers will become an increasingly important constraint to greater intra-ASEAN trade. Lists of non-tariff barriers have already been prepared, and these should speed up the process. However, a schedule for removal should also be compiled, and this could preferably be coordinated with the schedule for removal of tariffs but can move more quickly if so desired.

6. Other non-border issues. ASEAN will need to go beyond economic cooperation which concentrates only on border issues by giving greater focus on reducing other barriers to trade through harmonization and standardization. Technical barriers to trade can arise from different national requirements.
* Specific areas where harmonization can facilitate intra-ASEAN trade should be identified. International harmonization efforts of recognized institutions and bodies can be used as a base for this.
* It would also be useful to explore cooperative efforts in ASEAN regarding reciprocal recognition of tests, inspections and certification of products in the region. At this stage, harmonization in many areas may be too complex and costly to undertake, but it is important to identify areas where harmonization can help and assess how differences hamper intra-ASEAN trade.
* Additionally, there is a need to set up rules of fair competition in ASEAN.

7. Industrial cooperation and trade linkages. Industrial cooperation should be expanded and linked more closely with trade cooperation. Previous studies have found that foreign investment promotes greater trade linkages; a foreign firm both exports and imports more with firms in its home country. More often than not, the effect is positive in terms of the balance of trade. Additionally, stronger intra-industry trade will be a key factor for the eventual success of an ASEAN free trade area. Since the main instruments of industrial cooperation such as the AIJV and the AIC use large preference margins as incentives, which over time will be matched by the implementation of a free trade area, a different type of industrial cooperation will be required. Industrial cooperation in the future should deal with problems of unequal distribution of gains as well as seek to promote intra-ASEAN investment.

* As a first step, it will be important to identify and begin to remove barriers to direct foreign investment.
* The implications of offering national treatment to investors from ASEAN countries should be examined as a means of industrial cooperation. If the CEPT approach to creating a free trade area is chosen, national treatment can first be conferred to firms in the CEPT sectors where tariffs are reduced, a move that will directly link trade and industrial cooperation activities. Additionally, regionally-linked projects such as those in the “growth triangles” may also be considered.
* The present AIJV and AIC can continue to be utilized until the preference levels being offered under a free trade area make them redundant.
* Another future direction for intra-ASEAN industrial cooperation can be found in the areas of investment promotion and harmonization of
investment and industrial regulations. Although each member country may wish to maintain its own priority areas for attracting foreign investment, with the formation of a free trade area and of an ASEAN market, foreign investors will go to the most attractive member country to supply the entire region. Competition to provide better incentives will be costly and non-productive, making a common set of incentives and regulations desirable in the future. Each of the ASEAN countries presently has different incentives and conditions on foreign investment, but it is likely that there are more similarities than differences. A comparative review of such regulations will first be necessary to determine areas where harmonization can begin.

The implementation of the above recommendations will require a few institutional changes. A central organization that will be able to promote, facilitate, and monitor ASEAN economic cooperation as it enters higher levels will be needed. In addition to having technical expertise and other necessary functional characteristics, this organization will have to ensure that benefits are spread equitably throughout the region. Finally, some kind of dispute settlement mechanism will also have to be established. Recommendations regarding institutional changes are discussed in the final sections. It may also be useful to form a continuing committee of private individuals in ASEAN, along the lines of EFTA’s Consultative Committee, to provide an integral and continuing mechanism for generating a wide range of views on the impact of ASEAN initiatives on the sectors most affected by the economic integration process.

Finally, all ASEAN countries are unilaterally liberalizing their productive structures to render their economies more efficient and competitive. The continuation of this trend is of utmost importance, and, as most of ASEAN trade and foreign investment is transacted with countries outside of the region, any future accords to promote regional integration and harmonization should not buck this trend. On the contrary, ASEAN economic integration and harmonization must be outward-looking if its goals are to be achieved. Greater integration should be used to speed up the external liberalization rather than slow it down. Continued external liberalization would ease internal liberalization as it narrows initial tariff differentials. In this regard, the possibility of using maximum CEPT rates to harmonize external tariffs should be examined. Such moves would ensure a trade- and investment-creating ASEAN economic community.
III. Internal Policy Consultation

Given the growth in importance of capital movements, services, and infrastructural needs in the ASEAN region, it stands to reason that ASEAN should begin to look beyond border barriers and areas for standardization discussed in the previous section. An ASEAN economic community must also consider other non-border issues. These can be broken down into two general areas: (1) microeconomic or sectoral policies including trade-related investment measures (TRIMs), transportation and communication linkages, and other regulations affecting factor flows; and (2) macroeconomic policies. Although these non-border measures are not included in traditional schemes of economic integration, they constitute critical areas of modern economic development and present excellent possibilities for lucrative, mutually beneficial regional cooperation. As mentioned before, the proof of this is evidenced by the changes in the types of economic cooperation schemes in developed countries, which in the 1960s and 1970s concentrated on tariff harmonization but which in the 1990s are moving into these other areas which have become critically important since the 1980s.

Consequently, three key objectives can be identified for internal policy consultation: (a) the identification and removal of bottlenecks to ASEAN economic integration; (b) the facilitation of the process of future ASEAN economic integration by anticipating the kinds of policies likely to be conducive to it; and (c) the reaching of an agreement on joint policies to enhance the economic growth of ASEAN. A number of areas can be identified for consultation/coordination by ASEAN.

Macroeconomic Cooperation and Consultation

Domestic macroeconomic (especially monetary) policies such as those affecting interest rates, inflation rates and balance of payments positions in ASEAN countries have important ramifications for the flows of financial capital, especially because the domestic stockmarkets of the respective ASEAN countries have been growing at a phenomenal pace in recent years. Due to the closely interdependent nature of these markets, the coordination of domestic macroeconomic policies would be desirable to promote trade and capital flows and, even more importantly, stability and economic growth. Divergent monetary policies, resulting in differential rates of inflation, will make integration more difficult. Additionally, more stable exchange rates in ASEAN will not only encourage intra-ASEAN trade and
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investment but will also make the region more attractive to foreign investors.

No truly effective, systematic mechanism for ASEAN macroeconomic coordination and consultation exists. It would be useful to create a Macroeconomic Cooperation Consultation process as part of the ASEAN Economic Ministers meeting, with the participation of central bankers. The meeting should be held regularly and frequently in order to keep themselves abreast of rapidly changing international and domestic circumstances. The newly-established ASEAN Macroeconomic Outlook can be used as a technical resource in these meetings. It will provide a basis for discussion of the long-term structural issues and outlook in the region by giving the Ministers possible outcomes of policy changes. Additional organizational and technical support may also be required for this meeting.

Financial Intermediation and Investment

Intra-regional direct investment has grown, and there has been an increasing movement of people conducting business throughout the region. An ASEAN mentality has emerged where people from ASEAN feel comfortable doing business with other ASEAN businessmen. This phenomenon has occurred in part as a natural result of increased regional economic interaction, and in part as a consequence of efforts of the ASEAN Chamber of Commerce and Industry and associated institutions and networks. Nonetheless, there is much more which ASEAN as a regional entity can do to support and encourage direct investment flows, as has been discussed in the previous section. The major accomplishments in ASEAN cooperation in finance and banking include the establishment of the ASEAN Swap Arrangement, which provides a standby credit facility to alleviate temporary balance-of-payments problems, and of the ASEAN Reinsurance Corporation, a private-sector initiative to enhance ASEAN capabilities in the insurance industry. Some effort has also been made to increase the use of ASEAN currencies for intra-regional trade and investment. Although not technically a part of ASEAN cooperation, all of the ASEAN countries also belong to the Southeast Asian Central Banks Research and Training Centre (SEACEN) and the Southeast Asia, Australia, and New Zealand Association of Central Banks (SEANZA), where ASEAN Central Bankers meet on a regular basis. As with the case of trade in other services, ASEAN economic cooperation addresses important issues in the financial, transport and communication sectors but the
approach used is aimed more at information sharing rather than market opening as in the case of trade in goods.

With the establishment of stock markets and their subsequent explosive growth in the ASEAN countries, it is likely that capital flows between the countries in the region will begin to expand. Funds from other ASEAN countries can play an important role in the development of the fledgling stock markets. The easy convertibility of ASEAN currencies and the lowering of foreign exchange restrictions in ASEAN countries will contribute to this process. As such, transactions would become more substantial in the future, and it will be important to promote such flows and to avoid unnecessary barriers to them.

Trade in financial services is an important area to consider in economic cooperation discussions. A few countries have restrictive policies regarding domestic banking, though some of the restrictions have been eased in recent years. ASEAN members' banks already are found in each other's countries; however, a more liberal mutual granting of licenses can further facilitate financial flows. Such flows will accompany increasing trade flows, and it is necessary to allow trade in financial services to expand to meet the needs of traders and investors.

In addition, ASEAN may consider giving its approval for the establishment of an "ASEAN Equity Fund" in which the private sectors in all ASEAN countries could participate as a source of risk and venture capital in the region. This would spur new opportunities, create ASEAN-wide investments on large- and/or small-scales, and facilitate the twin ASEAN goals of pooling resources and markets. This Fund would complement existing institutions such as the ASEAN Finance Corporation and existing industrial programs such as the AIJV. The ASEAN Equity Fund could be funded internally by the private sector in ASEAN countries with contributions also coming from Northeast Asia and elsewhere. Investments with various combinations of ASEAN and foreign capital would likewise be allowed, subject to the constraint that production be located in ASEAN countries. Additional incentives, such as providing national treatment to firms under this Fund, may also be considered by ASEAN.

Labor and Non-bank Services

ASEAN has had a fair amount of success in cooperation in tourism. An ASEAN Tourism Information Centre has been established to collect and provide relevant information and promote tourism activities in the region. ASEAN member countries have taken turns in promoting tourism in their
countries through the Visit Indonesia Year and other schemes. Visit ASEAN Year 1992 has been declared in close coordination with national tourist organizations. Some progress has also been made in transport and communications, especially in terms of information sharing. Growth in intra-ASEAN trade in services is conspicuous in some sectors such as entertainment, but has been less evident in other sectors such as banking. Little has actually been attempted by ASEAN to actively promote intra-regional trade in services. Yet the service sector comprises a growing share of total output and trade and will likely play a key role in ASEAN's future.

Some preliminary measures to expand intra-ASEAN trade in services may be warranted at this time. One important step forward would be an improvement and coordination of data-gathering efforts. Other areas where restrictions can be eased should also be examined. Legal services, construction, and engineering services may be possible areas. Such steps may help to alleviate serious bottlenecks for skilled workers in some of the ASEAN countries.

Additionally, some consideration should be given to means whereby the already large flow of workers between ASEAN countries can be facilitated and the irritations that sometimes develop assuaged. Cooperation in training facilities and in sharing experiences may help in this regard.

Trade Infrastructure for Economic Integration

ASEAN cooperation in transportation and communication, which constitute a critical service in facilitating economic integration, is an important but neglected topic in discussions of economic cooperation in the region. In the modern age, communications, especially telecommunications, has become a key input into the development process, and transportation is an important element of trade, as well as a key factor in tourism. There has been progress in these areas, but much more can be done. The move toward trade liberalization will require the coordination of investment in transportation and communications infrastructure. It also implies the removal of hindrances so as to facilitate movement. Inevitably this entails the development of infrastructure and transport policies.

Because it really relates to the upgrading of domestic infrastructure in a general context, trade infrastructure for economic integration actually falls into cooperation under the "common needs" category. The main factors which have slowed cooperation have been the lack of funds, the lack of manpower to carry out projects, the perceived lack of urgency and will, and the changing priorities of the various countries concerned. In view of
these and of the challenges ahead, the following recommendations are tabled for consideration.

1. Identify major corridors of movement based on location of economic centers and forecast of demand.
2. Identify projects which are ASEAN in nature. For example, water transportation is crucial for trade and investment throughout the region, as well as within countries such as Indonesia and the Philippines. Poor transportation adds to the costs of bilateral trade; sometimes, foreign trade becomes cheaper than internal trade with distant or isolated countries.
3. Encourage active private sector participation in identified projects.
4. Consider the harmonization of technical aspects of design, safety and evaluation standards for infrastructure. National transport and communications policies should complement regional infrastructural development.
5. In light of the fact that cooperation in trade and industry is affected by cooperation in transportation and communications, the topics under the auspices of COTAC should be coordinated more effectively with those of other economic committees.

By increasing ASEAN cooperation links in the area of transportation and communication, ASEAN stands to gain much. By effectively enhancing the physical means of communication and cooperation in the region, intra-regional trade and investment will likely be facilitated greatly.

IV. External Economic Relations

As noted earlier, the international economic system is rapidly changing. In the 1980s, a trend toward increased protectionism began at the same time that many Asian developing countries were beginning to liberalize their domestic and external economic policies. In addition to the "old style" barriers to trade, many new forms of protectionism are rising in importance. New and increasingly important areas of trade have emerged, such as trade in services and intellectual property (e.g., computer software), which are excluded from the central organ under which multilateral trade negotiations take place, i.e., GATT. The problems with multilateral solutions are many, and these have manifested themselves with a vengeance at the Uruguay Round of GATT, which almost ended in failure in December 1990 but has now gotten a renewed two-year lease on life. Moreover, the increasing trend toward trade blocs in the international economy poses questions on whether or not there will be a "Fortress Europe" or a "Fortress North America" and on the effects of these possible eventualities.
ASEAN has been changing rapidly, and all countries are essentially basing their development strategies on outward-looking commercial policies. Exports, in particular manufacturing exports, play a key part in this strategy, as does direct foreign investment. Like Japan and the NIEs before them, ASEAN countries have reaped great benefits from this approach. However, as ASEAN has become more interwoven with the global economy, it has become more susceptible to external changes. Hence, a breakup of the multilateral trading system and/or increased protectionism are of great concern to all ASEAN countries.

A joint response to these actions, as well as in addressing future responses to international developments, is called for. ASEAN experiences show that a joint approach towards the external world is preferable to a solitary one. However, the external strength of ASEAN is a function of its internal cohesiveness. Expanded cooperation in trade, investment and other areas discussed in the previous section will be necessary to establish ASEAN firmly as a single bargaining unit.

Methods for Greater Cooperation in External Relations

Under those circumstances, ASEAN may consider several options which include expanding the ASEAN membership, strengthening the extra-ASEAN linkages, participating in wider regional groupings, and forming coalitions with third countries. These options are not mutually exclusive and a judicious mixture may be desired.

On the first point, while a bigger ASEAN with additional members will certainly prop up the stature of ASEAN internationally, such an expansion at this juncture is likely to create more problems than solutions. It can be argued that ASEAN should consolidate itself before it expands. Even more importantly, the other countries in the region are undergoing significant changes, moving from a centrally-planned approach to a market-based approach in several cases. Nonetheless, ASEAN may consider the granting of some form of “associate membership” to these countries as a prelude to full membership perhaps sometime in the future.

Second, although the Post-Ministerial Conferences (PMC) have been a useful external relations instrument for ASEAN, there is a need to expand the PMC to look at other pressing issues, many of which fall in the field of economics. Already this has begun with the formation of the Trade and Investment Consultative Council (TICC) under the ASEAN-U.S. Initiative. The “ASEAN-U.S. Initiative” (AUI) framework, which recommends that ASEAN and the United States negotiate an umbrella agreement that would
enhance bilateral relations, is one alternative to enhancing bilateral external relationships. It allows the relationship to develop at a pace that is acceptable to both parties while at the same time including mechanisms for achieving long-term targets such as a free trade area. A next step might be an "ASEAN-Japan" or an "ASEAN-Korea" Initiative. Alternatively, ASEAN could expand the PMC to include economic issues.

Third, ASEAN has adopted a common approach in much of its external relations, but it has failed to act as a unit. This failure has been costly in some instances. For example, by not taking a joint membership in APEC, ASEAN has allowed itself to be overshadowed by developed countries like Canada, Japan, and the United States. The AUI agreements have been made more difficult by the need for six separate agreements. It will take some time for ASEAN to be perceived as a single entity, but the movement toward an ASEAN economic community will be the first step.

Fourth, ASEAN should play a strong role in any larger regional grouping that is likely to surface. The worst-case scenario of the world splitting up into regional blocs may not occur but ASEAN should insure itself against any such risk. At the same time, ASEAN's stake in the Pacific economy is growing, with East Asia emerging as an important trade and investment partner. ASEAN needs to play a more active role in APEC, which can be used as a forum to address problems emerging from the increased economic interactions and interdependence in the region. Some macroeconomic consultations are already being held within APEC. ASEAN can use this as a forum to ensure that the adverse effects of policy changes in the developed countries on ASEAN are minimized and that bilateral trade issues among the advanced countries, particularly between the U.S. and Japan, would consider the implications of the settlement on ASEAN.

The proposed East Asian Economic Grouping (EAEG) can also be seen as part of the Pacific process. The EAEG can be used to voice the concerns of the region to the rest of the world, thus complementing APEC which is primarily concerned with intra-regional issues. At the same time, the closer relationships built among the East Asian countries can be used as a springboard for Asian integration should the world economy become fragmented into trading blocs.

Fifth, ASEAN countries should continue to work together to promote GATT, whose present role is commendable in that active consultation between the countries is the rule. Nonetheless, a more formal consultative mechanism should be considered. In the GATT negotiations, the stakes are high; ASEAN needs to maximize its clout by presenting joint positions representing its mutual interests.
In sum, ASEAN joint positions in external matters can yield significant results. Given the threat of rising protectionism, mercantilism, and the prospect of a world breaking up into trading blocs, ASEAN needs to voice its interests forcefully. And if that the voice is to be heard, it must be loud and clear. This can only be accomplished if ASEAN speaks as one. At least in the short to medium run, there can be no ASEAN equivalent of an EC commission that can be solely responsible for commercial policy of the entire region, as this would require ASEAN to have a common commercial policy to begin with, such as the customs union found in the EC. However, the formation of an ASEAN economic community which enhances its external relations as outlined above will be an important move forward.

V. An ASEAN Framework Agreement: Foundation for the Future

Based on the above analysis, it is clear that ASEAN countries could prosper from greater economic harmonization and integration in an ASEAN Economic Community (AEC), which we refer to here as an "ASEAN Free Trade Area Plus," including intra-regional free trade, non-border cooperation, and macroeconomic consultation. By creating a more unified economic structure in ASEAN, member countries would not only stimulate intra-regional trade and investment but also be able to more easily act as a group and thereby maximize its clout in international organizations, discussions with dialogue partners, etc. In addition, through more regularized meetings of economic ministers, ASEAN would be able to facilitate macroeconomic consultation and take joint positions and actions in addressing common problems. Moreover, a cohesive ASEAN would present to the world—and to itself—a large market and diversified production base. In sum, dynamic benefits from an AEC could be substantial, as has been the case for other successful economic groupings.

Indeed, ASEAN has already committed itself to a special vision of market sharing and resource pooling embodied in the declarations of the first ASEAN summits. The logical manifestation of this vision will likely be a type of ASEAN "free trade area plus" discussed above. To best realize this vision, it will be necessary to construct the formal groundwork and mechanisms which enhance cooperation and to allow member states to move at a suitable pace to become a cohesive unit. Hence, the goal of this section is to explore the characteristics and possible elements of an ASEAN Framework Agreement.
The time has come for the ASEAN leaders to consider an ASEAN Framework Agreement. For while important achievements have been made in the form of basic agreements throughout ASEAN's existence, no umbrella agreement yet exists under which such agreements can expand and flourish. The present system of intra-regional cooperation was, perhaps, well-suited for previously envisioned purposes of ASEAN. However, times have changed. Imperatives and opportunities for greater cooperation have never been more compelling.

This section first describes some of the most salient characteristics of an ASEAN Framework Agreement, and then details the needs and opportunities attendant to putting the framework in an umbrella agreement form. This route will allow ASEAN to move forward in a steady direction toward the creation of an ASEAN Economic Treaty. It is recommended that an endorsement in principle of an ASEAN free trade area be reached at the Fourth Summit. Detailed studies and preparatory work regarding the scope, pace, and other issues involved in establishing an ASEAN free trade area will be undertaken so that the timing and the final form of the ASEAN Economic Community could be decided at the Fifth Summit, presumably in 1994.

Characteristics of an ASEAN Framework Agreement

ASEAN is a heterogenous region, with rich and unique histories and cultures, as well as divergent legal traditions. An ASEAN Framework Agreement will have to reflect the unique nature of ASEAN. The Treaty of Rome, for instance, was greatly facilitated by the similarities in the social, economic, historical, and especially legal traditions of the original member states. ASEAN's case is quite different, and, ultimately, an ASEAN Framework Agreement will embody the special characteristics of the contracting parties, to the advantage of all.

In politics, society, and law, Western countries tend to have a much more formal structure than Asian countries. Legal traditions in the West based on a Constitution or on Common Law precedents take a more straightforward approach to advocating the common cause. Asian cultures and traditions, on the other hand, generally lend themselves to a looser framework that embraces a different means to achieve the same goal of justice and social good. In this sense, ASEAN countries are quite "Asian" to varying degrees depending on their respective historical circumstances.

It is logical, therefore, that an ASEAN Framework Agreement should embrace a relatively flexible and loose structure, rather than a very
legalistic one. In contrast, the European Communities have a strict system of legislation that comes from executive and legislative branches, and a Court of Justice as the ultimate arbitrator whose decisions are binding even above national law. ASEAN cannot really look to this model for guidance in the way, for example, that it has studied the institutional structure of the EC Commission. Instead, the ASEAN Framework Agreement will have to exhibit the consensus approach that has been ASEAN’s hallmark since the beginning. While the framework agreement’s elements would have to be binding, thus necessitating that some sort of common implementation process and monitoring system be adopted, it should not consider, at least in the short to medium run, creating a Court of Justice.

Hence, the framework agreement must leave ASEAN with enough flexibility to accommodate regional diversity and provide sufficient room within which ASEAN could grow. It should prove to be a critical catalyst in propelling ASEAN economic cooperation in the 1990s and beyond.

**An ASEAN Umbrella Framework**

In order to promulgate a functional framework agreement best suited to its needs and for the establishment of an ASEAN Economic Community, ASEAN should first establish an umbrella agreement under which the basic direction and elements of the framework agreement would be defined. The umbrella agreement would first formalize some of the arrangements that have developed since the original ASEAN Declaration in 1967 and establish goals for further cooperation. An umbrella agreement would give visibility to the Summit meeting and vision to the concept of ASEAN cooperation, which is especially needed because ASEAN is entering into broader regional arrangements such as APEC in which it can act more effectively as a group. It should also provide domestic businesses and foreign investors with a sense of confidence in the future of ASEAN cooperation as leadership and generational changes occur.

Under the umbrella agreement, the relevant border and non-border issues and policies could be addressed and coordinated, including the means to enhance economic interchange, roll back non-tariff and other barriers, resolve disputes, and coordinate harmonization measures. The umbrella agreement would establish the means for bilateral/multilateral arrangements between two or more member states, for example, in bilateral investment agreements and in the establishment of bi- and pluri-lateral agreements, such as the “growth triangles” approach.
Institutional Implications

An effective implementation of the umbrella agreement will likely require new institutional arrangements. Currently, the ASEAN machinery can be summarized as having four essential features: (1) primacy of the ASEAN foreign ministers; (2) national control, i.e., lack of supranational objectives; (3) decentralized structure to maximize participation of officials in all areas of ASEAN affairs; and (4) a limited, centralized administrative organ created in the ASEAN Secretariat. Several studies have considered thoughtfully how the ASEAN machinery should be restructured; for example, at present the ASEAN ministers are considering the recommendations of the "Eminent Five" report, which gives two options for changing the status quo. It is not the intention of this study to pre-empt their proposals; however, if an ASEAN Economic Community is to be achieved, it will be necessary to undertake certain minimal reforms:

1. The scope of involvement of the ASEAN economic ministers in issues relating to their responsibilities, such as in external economic relations, will have to be enhanced.

2. There is a need to strengthen the ASEAN Secretariat with a technical capacity and monitoring capabilities. The ASEAN machinery and the ASEAN Secretariat will need to take regional rather than national approaches to economic cooperation and issues. The necessary degree of supranational capabilities endowed in ASEAN will depend on the nature of the ASEAN Economic Community and the political will of its leaders. For example, EFTA grants no real supranational responsibilities to its Secretariat, while the EC has a very well-defined supranational entity in the EC Commission. ASEAN will have to choose its own course.

3. Other critical areas of economic cooperation would not require any changes in the institutional structure per se. Consistent with the goals of the umbrella agreement, an important institutional change would be to arrange more frequent ministerial meetings to discuss domestic macroeconomic developments and cooperation/coordination in monetary and fiscal policies, as well as discussions to address external commercial policy issues. To accomplish this, a special system of frequent meetings under the ASEAN Economic Ministers, to be called the Macroeconomic Cooperation and Consultation (MCC) process, would be held. Participants in these meetings would include not only the relevant economic ministers but also the central bankers, who could also seek the advice of private bankers in the to formulation of the agenda of the MCC. A stronger ASEAN
Secretariat and the newlycreated ASEAN Macroeconomic Outlook program would be critical technical resources for the meetings and for helping provide follow-up services.

**ASEAN Economic Treaty**

As part of the umbrella agreement, the framework would also allow for the creation of a flexible ASEAN Economic Treaty, characterized by both binding and non-binding elements intended to create an ASEAN Economic Community. The Treaty's elements may include the following:

1. **Statement of the basic purpose and thrust of ASEAN in a general re-emphasis of the goals embodied in the Bangkok Declaration and subsequent agreements,** for example, by stipulating the goal of ASEAN cooperation to be the advocacy of the common good of the member states, enhance their well-being, security, joint economic progress and sustainable development, and exercise of their national sovereignties. To attain these goals, the ASEAN member states need to agree to cooperate in specific areas of mutual interest, such as trade, investment, human resource development, and other means of improving resource and market pooling.

2. **The organizational machinery of ASEAN would be recast to include changes required in establishing the envisioned ASEAN Economic Community,** including a stronger role for the ASEAN Economic Ministers in external economic affairs, the enhancement of the technical and monitoring capabilities of the ASEAN Secretariat, and the initiation of greater macroeconomic cooperation and consultation in the MCC process. Also, changes in the ASEAN institutional structure may be deemed necessary.

3. **Direction and purpose of economic harmonization and cooperation.** This section would address some longer-term economic goals for the member countries in a realistic fashion. It may be here that many of the essential components of the framework agreement would be formalized. For example, the goal of an ASEAN free trade area as articulated in the ASEAN Economic Community could be explicitly incorporated into (a) the Treaty section of the framework agreement including the provisions relating to the freer movement of services, capital and labor; (b) the creation of a dispute settlement mechanism; and (c) the establishment of a process for harmonization of regulations in certain areas (product standards, investment regulations). Moreover, the processes for setting up "2 plus x" types of economic arrangements, such as the Johore-Singapore-Rial "growth triangle," could be formally included in the Treaty. Also, the formal role of the
private sector in ASEAN economic cooperation needs to be specified. Finally, the endorsement of a private-sector based ASEAN Equity Fund to assist industrial cooperation and development should be included in the Treaty.

**Conclusion**

From the above discussion, it is clear that many benefits could be reaped through the formalization of economic cooperation in an ASEAN Framework Agreement. However, the agreement must be characterized by a flexible structure in which ASEAN can enhance regional integration, cooperation, and consultation at a suitable pace. A decision in principle to form an ASEAN Economic Community and an ASEAN Framework Agreement, perhaps including an Economic Treaty, at the Fourth ASEAN Summit would not only be a historical development but a watershed in ASEAN economic cooperation as well. In short, it would be the best mechanism through which ASEAN can chart its future course in the 1990s and beyond.

Whether or not ASEAN will move in this direction critically depends on the political will to do so. However, internal and external imperatives and opportunities related to greater economic integration and harmonization point to the need to create an ASEAN Economic Community. It is time for ASEAN to move onward and upward in the pursuit of its economic destiny.
PART TWO

Background Papers
I. Performance, Challenges and Opportunities

Progress in ASEAN trade and industrial cooperation has been steady, but intentionally gradual. ASEAN graduated from providing preferential tariff rates using the product-by-product approach into the more effective across-the-board method. As a result, the coverage of goods and margins of preferences offered have increased over time to more than 15,000 items accorded a minimum of 25 percent margin of preference. The exclusion list, while still large, is shrinking, and lists of existing non-tariff barriers have been exchanged to facilitate negotiations to reduce them.

Despite the progress made, much remains to be done. It is generally agreed that little trade has actually been created under the ASEAN Preferential Trading Arrangements Agreement (PTA). Data indicate that utilization rates have improved but remain low (Pangestu et al. 1991). The time-consuming bureaucratic procedures, high domestic content requirements, monetary problems, and lack of dissemination of information to the private sector appear to be important drawbacks. But what is perhaps the most crucial problem with the PTA has been a lack of will on the part of ASEAN leaders to pursue real economic integration.

Similarly, despite the progress made, there is a need to enhance industrial cooperation. ASEAN has three basic industrial agreements: the ASEAN Industrial Products (AIP), ASEAN Industrial Complementation (AIC), and ASEAN Industrial Joint Ventures (AIJV). The shift in emphasis away from the government-initiated AIPs to the more private-sector based AIJV and the emergence of brand-to-brand complementation in the AIC are important steps forward. Likewise, the increase in the allowable equity share for foreigners from 49 to 60 percent and the significant increase in the

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1. Major contributor; Ponciano Intal, Jr. President, Philippine Institute for Development Studies. The author gratefully acknowledges the assistance of Mr. B.O. Johansson, Deputy Secretary-General, and the staff of the Secretariat of the European Free Trade Association. Any error in the paper is the sole responsibility of the author.
margin of preference for AIJV-status products from 50 percent under the PTA to 90 percent has been critical in making the program more attractive to the private sector. Nonetheless, the time and energy involved in getting a product on the list of approved items is still excessive. Monitoring and implementation problems continue; for example, it has been found that participating countries have at times not provided the agreed-upon MOP. Moreover, the pre-approved list of AIJV products has to be lengthened in order to have a more meaningful AIJV program. Presently, there are only a few actual working projects under these programs, and the investment created has been minimal.

In short, while ASEAN cooperation program in principle have successfully transformed themselves to incorporate a more practical, market-based approach, in fact, the success of these programs has been limited. Having realized this and the important attendant opportunities of enhanced regional cooperation, the ASEAN Economic Ministers have been looking for means to lead regional cooperation to higher levels through greater harmonization and integration.

Indeed, in light of the rapidly changing international and domestic economic environment, the time has come for ASEAN to look to new mechanisms of harmonization and integration. First, all ASEAN countries are unilaterally liberalizing their productive structures to render their economies more efficient and competitive. Continuing this trend is of utmost importance, and, as most ASEAN trade and investment is transacted with countries outside of the region, any future accords to promote regional integration and harmonization should not buck this trend. On the contrary, ASEAN economic integration and harmonization must be outward-looking if its goals are to be achieved. Given the internationally-minded leaders of the ASEAN countries, greater integration will likely speed up the external liberalization, rather than slow it down. Such moves would ensure a trade- and investment-creating ASEAN economic zone.

Second, although the global trading system continues to be relatively open to trade, there are disturbing trends on the horizon. Threats and actual cases of protectionism through non-traditional means such as orderly marketing arrangements and anti-dumping duties have been of considerable concern to ASEAN policymakers. A successful conclusion to the Uruguay round of the GATT negotiations is still far off, and it is uncertain whether such a conclusion will actually be as far-reaching as is required to thwart the increasing trend toward a more restrictive trading environment.
Also, the rapidly-proliferating trade grouping accords, e.g., the “EC1992” movement toward economic union, the European Economic Area negotiations between the European Community and the European Free Trade Association, the pan-European economic accords, and the possible inclusion of Mexico and other Latin American countries in the Canada-U.S. Free Trade Area discussions, run the risk of leading to an increasingly fragmented world trading system in which ASEAN could be an “odd-man-out.”

Moreover, economic liberalization in formerly-planned economies in Europe and Asia will pose a competitive threat to ASEAN in the short and medium terms. Eastern Europe and, it would appear, the Soviet Union are beginning to implement more market-oriented economies, and they will end up competing in trade and for investment with ASEAN. China has had an “open-door policy” since 1979, and competes in many of the labor-intensive industries in which some ASEAN countries have comparative advantage. Vietnam and Laos, as well as the South Asian countries of India and Pakistan, have also begun economic reform measures which will render these economies more competitive.

These external changes underscore the need for closer market-sharing among the ASEAN countries, a goal explicitly built into ASEAN declarations. Not only will harmonization and integration of the ASEAN economies lead to a stable, regional, and dynamic market from which ASEAN countries will benefit; it will also allow for a more competitive regional division of labor and resource pooling, leading to greater economies of scale and an important impetus for direct foreign investment. A more cohesive ASEAN economic entity can meet the challenges and seize the opportunities in the world trading system ahead.

II. Enhancing ASEAN Trade and Industry Cooperation: Creation of an ASEAN Free Trade Area

Proposals for enhancing ASEAN trade and industrial cooperation run primarily along two modes of economic cooperation; namely, deepening of the PTA and strengthening of industrial cooperation programs, and the creation of a free trade area. However, because a free trade area is the logical next stage of a preferential trading arrangement, the proposals for deepening the PTA and industrial cooperation and for the creation of a free trade area are best seen as fundamentally complementary and sequential.
Given ASEAN’s tendency for gradual integration processes, it is clear that the creation of a free trade area will take time. Nevertheless, a political decision now to create a free trade area down the road over a definite time period (say, by the year 2005) is important for shaping the direction, approach, and pace of the process of ASEAN economic cooperation in the interim. Indeed, it can be argued that it is precisely because the ASEAN member countries have not made a political decision and commitment to the creation of an ASEAN Free Trade Area by a definite date (i.e., there is no specific and definite end goal to the current efforts at ASEAN economic cooperation) that the efforts have been slow, seemingly half-hearted and with little impact on intra-ASEAN trade and investments.

To be effective, ASEAN will have to go beyond a traditional free trade area which, strictly defined, only ensures no tariffs on intra-regional trade. It is recommended that ASEAN embrace a “free trade area plus” formula that will go beyond regional elimination of tariffs into other areas that are integration-in-nature, that best suit ASEAN’s unique characteristics, towards the ultimate goal of promoting holistic, sustainable development.

A decision to create an ASEAN “free trade area plus” will require some rethinking on the current approaches to ASEAN economic cooperation. For example, it may mean doing away with the product-by-product approach in view of the fact that successful regional associations (e.g., EFTA, EEC) followed an across-the-board approach (except for explicitly enumerated items) within a given timetable whereas the unsuccessful ones followed the product-by-product approach (Wonnacott and Lutz, 1989, p. 77). It would also mean a serious redirection of efforts toward reducing non-tariff barriers to trade and strengthening the rules of origin and monitoring mechanisms. Likewise, the member countries would have to take very seriously the distribution among themselves of the gains from the creation of the free trade area in order to ensure the sustainability of the free trade arrangement.

**Will an ASEAN Free Trade Area be Beneficial?**

It is useful at this juncture to examine the possible impact of an ASEAN Free Trade Area on the member countries. Will an ASEAN Free Trade Area be beneficial to the member countries? Are conditions ripe for the successful implementation of an ASEAN Free Trade Area? What will the effect be across industries? Will the distribution of gains be acceptable to all members? These are important questions of concern to policymakers which have to be addressed.
A recent study by Imada, Montes, and Naya (1991) provides the most comprehensive evaluation so far of the issue of intra-ASEAN trade preferences and the creation of a free trade area. The study indicates that ASEAN was sensible in being initially cautious and deliberate in its economic cooperation efforts rather than rushing headlong into a free trade area or customs union, as the other economic integration groupings among developing countries did. Until the 1970s, the conditions for a successful ASEAN free trade area were barely present; hence, had ASEAN pushed for closer economic integration then, the efforts could have been undermined and even detrimental to ASEAN countries.

Recent conditions have been more propitious for closer ASEAN economic cooperation, and there is now greater convergence of economic, export, and tariff structures among the member countries. There is growing intra-industry trade within ASEAN, albeit centered around Singapore. The intensity of economic interaction among the ASEAN member countries does not, however, come close to the level of economic interdependence in Western Europe at the start of the European Economic Community or the European Free Trade Association in the early 1960s.

Notwithstanding the economic relationships that are developing within ASEAN, the recent study by Imada et al. indicates that a large 50 percent intra-ASEAN tariff preference would result in net welfare gain for the ASEAN members. The gains, and the sectoral impacts, are more pronounced under an ASEAN free trade scenario (see Table 1). Specifically, intra-ASEAN imports and exports will rise sharply and the increase in trade will be fairly distributed. Their study shows that with free trade, the growth of intra-ASEAN imports would increase between 40 percent (for Malaysia) and 70 percent (for Thailand). The only exception is Singapore whose imports from the ASEAN will increase only slightly because of its virtually zero initial tariffs. Although the sharp increase in imports is partly due to the diversion of imports from non-partner countries, this trade diversion effect is less than trade-created. Total exports of ASEAN member countries would increase between 1.5 percent (for Singapore) and 5.0 percent (for Thailand) as a result of the free trade area. Unlike in the case of imports, the increase in exports would not be at the expense of exports to the rest of the world. Thus, the fear that an ASEAN Free Trade Area will be principally trade diverting is unfounded.

The simulations by Imada et al. suggest that the creation of an ASEAN free trade area would result in shifts in the distribution of industrial activities among the ASEAN member countries, but no one country will
### Table 1

**Summary Results of a Free Trade Area in ASEAN**

*(Change in U.S.$ millions and percentage change)*

<table>
<thead>
<tr>
<th>Exports to:</th>
<th>Imports from:</th>
<th>Total consumption&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Intra-ASEAN</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>Indonesia</td>
<td></td>
<td>95.3</td>
<td>230.1</td>
</tr>
<tr>
<td>%</td>
<td>Malaysia</td>
<td></td>
<td>0.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Philippines</td>
<td></td>
<td>115.0</td>
<td>329.4</td>
</tr>
<tr>
<td>%</td>
<td>Singapore</td>
<td></td>
<td>29.3</td>
<td>53.9</td>
</tr>
<tr>
<td>Philippines</td>
<td>Thailand</td>
<td></td>
<td>86.7</td>
<td>188.0</td>
</tr>
<tr>
<td>%</td>
<td>Rest of world</td>
<td></td>
<td>0.3</td>
<td>52.8</td>
</tr>
<tr>
<td>Total</td>
<td>Total production&lt;sup&gt;b&lt;/sup&gt;</td>
<td></td>
<td>52.7</td>
<td>620.0</td>
</tr>
</tbody>
</table>

**Note:** Production for domestic consumption is portrayed as individual country trade with itself in this table.

- Total consumption = total imports + production for domestic consumption.
- Total production = total exports + production for domestic consumption.

*Source: Imada, Montes and Naya (1991).*
dominate the region. The simulations indicate that for Indonesia, the largest percentage increases in overall production will occur in labor- and resource-intensive industries such as textiles, wood products, paper and paper products, and other manufactures while the declining sectors would include food products, non-metal products, and transport equipment. The largest production increases in Malaysia would center around the more labor-intensive sectors like clothing and wood products and the more capital-intensive machinery sector; the declining industries would include food products, glass and glass products, and non-metal products. For the Philippines the largest production increases would be in more capital-intensive production including non-metal manufactures and electrical and non-electrical machinery with small declines in wood products, industrial chemicals, and other manufactures. Singapore’s production increases would be in heavy industries such as industrial chemicals, iron and steel, and transport equipment while several labor-intensive industries such as textiles and clothing would post production declines. Thailand’s production increases would primarily be in food products, leather products, metal and non-metal products and electrical machinery; production declines would be in wood products, machinery, and professional goods industries. It must be noted, however, that the above-mentioned sectoral results should be viewed as merely indicative because of the still dynamically changing patterns of comparative advantage among the ASEAN member countries.

The results of the simulations appear modest in the aggregate when considered vis-à-vis the usually difficult process of negotiations for economic integration. However, all static partial equilibrium analyses of economic integration have historically shown modest results, even for the successful EEC and EFTA. Static partial equilibrium analyses fundamentally underestimate the effects of economic integration because they ignore what have proven to be very important factors in economic integration, namely, the dynamic effects of achieving economies of scale and increasing efficiency in production, of learning by doing, and of expanded investments. Moreover, if intra-ASEAN trade liberalization is followed by expanded industrial cooperation and harmonization of industry-related policies and standards (e.g., product standards), the benefits from an ASEAN Free Trade Area are likely to increase further. Also, a well-defined program of intra-ASEAN cooperation will further improve the benefits of a free trade area by, among others, strengthening complementarities, reducing infrastructural and financial bottlenecks, and improving admin-
istrative mechanisms supportive of trade. Thus, on the whole, the results of the simulations by Imada et al. indicate that it is worthwhile to aim for the eventual creation of an ASEAN Free Trade Area but at the same time to be deliberate in its pursuit. Considering that the creation of an ASEAN Free Trade Area is the logical goal of the current intra-ASEAN economic cooperation, the policy challenge facing the ASEAN member countries is how to deepen intra-ASEAN economic cooperation in the interim which, in the process, would ensure the success of the ASEAN Free Trade Area.

III. The Road to an ASEAN Free Trade Area

The road to the creation of an ASEAN Free Trade Area requires the deepening and expansion of the ASEAN PTA, internal tariff harmonization and reduction, external tariff harmonization (i.e., narrowing of range of MFN rates), and the elimination of intra-ASEAN import and export restrictions.

Deepening the ASEAN Preferential Trading Arrangement

Deepening the ASEAN PTA essentially involves increasing the margin of preference (MOP) in the PTA and, more importantly, harmonizing and reducing the size of the exclusion list. Equally important is increasing the utilization of the PTA preferences through improvements in its implementation.

The COTT Interim Technical Secretariat, in its review of the implementation of the Third Summit decisions on ASEAN trade cooperation, concluded that the target reduction by 1992 of the exclusion list of individual member countries to not more than 10 percent of the number of traded items and 50 percent of the value of intra-ASEAN trade will be largely met. Likewise, the schedule of deepening toward 50 percent of the MOP of the items in the PTA lists of member countries is on stream. Nevertheless, the exclusion lists are far from harmonized and most items on the lists have high tariff rates. Moreover, by 1994 there will still be a significant number of items on the PTA lists that will continue to have MFN rates adjusted for MOP of more than 20 percent in intra-ASEAN trade (COTT-ITS 1991).

In order to deepen the PTA, the exclusion lists would have to be narrowed further and more items would have to be phased into the schedule of margin of preference in the PTA. In addition, the MOP needs to be increased. Considering that the items in the exclusion lists are
presumably "sensitive items" from the point of view of the individual member countries, a gradual deepening of the MOP may be resorted to in order to accommodate the internal policy consensus and industry restructuring that may be needed in the individual member countries. The COTT recommended to the ASEAN Economic Ministers at its 22nd meeting in Bali an increase in the margin of preference from 50 to 75 percent by 1999 and a reduction in the number of items in the exclusion lists to no more than 5 percent of all traded items by 1999 from the current 10 percent (COTT-ITS 1991).

The range of tariff rates on the currently excluded items is wide—from zero percent to 100 percent, although most are in the 21 - 50 percent range. In the case of Thailand, a majority of the excluded items have tariff rates above 50 percent (COTT-ITS 1991). Given the wide range of MFN rates, deepening the margin of preference will greatly increase the incentive for trade deflection. Making the rules of origin stringent is one way of preventing trade deflection. However, stringent rules of origin would result in cumbersome bureaucratic procedures and contribute significantly to the low utilization of PTA preferences.

A non-distortive deepening of the preferential trading arrangement requires two measures. The first is the narrowing of the MFN-based tariff band of the ASEAN member countries. A narrow tariff band not only reduces the incentive for trade deflection but also has the positive effect of reducing the MOP-adjusted MFN rates of items currently in the PTA lists, considering the usually cascading nature of tariff structures. The second measure is the phasing in of more excluded items into the PTA lists. This can be done "sectorally," e.g., by the sequential phasing in of commodity groups in related industries or of commodities according to stages of processing. An example of sectoral phasing-in is suggested by ISEAS for the ASEAN COTT wherein commodities are grouped according to 3-digit Harmonized System (HS) codes (ISEAS 1991).

**Common Effective Preferential Tariff**

The Common Effective Preferential Tariff (CEPT) arrangement proposed by Indonesia at the 22nd ASEAN Economic Ministers' meeting in Bali is a promising, innovative approach to trade liberalization, as it provides a means for harmonizing internal tariff rates. The CEPT arrangement requires that, given the differences in the MFN rates among the ASEAN member countries, each ASEAN member country grant the appropriate margin of preference in order that a uniform internal ASEAN...
tariff on intra-ASEAN trade will be achieved. As initially proposed by Indonesia, the CEPT arrangements will be applied on specified industrial products as a complement to ASEAN industrial cooperation. The ASEAN ministers approved the proposal during the meeting and identified cement, fertilizer, and pulp in the initial list of products.

In a subsequent special meeting in March 1991, the ASEAN Senior Economic Officials spelled out the implementing guidelines of the CEPT for possible adoption by the ASEAN Economic Ministers. Among the noteworthy provisions of the guidelines are the following: (1) the application of CEPT on AJJV products by extending the MOP on a product-by-product basis or by the direct application of the agreed common effective preferential tariff on AJJV products, whichever is feasible; (2) member countries with MFN rates lower than the CEPT need not raise their tariff rates to CEPT levels; (3) member countries will propose the product range to be included; (4) the ASEAN content requirements under the PTA will be followed; and (5) the maximum CEPT is 20 percent and this will be reduced over a fixed time period to zero.

Closer examination of the CEPT arrangement indicates that it will likely have little impact on intra-ASEAN trade and investments if it is implemented on a product-by-product basis as initially proposed. The product-by-product approach has been demonstrated in the ASEAN experience to be time-consuming and less meaningful because the offered industries tend to be those where difficult adjustments need not be undertaken; hence, the trade-liberalizing impact of the measure is minimal. In this regard, it is to be noted that two of the three industries initially identified for the CEPT scheme (i.e., fertilizer and pulp) are essentially low tariff items in the ASEAN and that the three identified industries have very high incidence of non-tariff measures. Hence, it is unlikely that the CEPT will be a significant inducement to intra-ASEAN trade in the three products.

The likely scenario under a product-by-product approach is that many of the products that will be offered by the ASEAN members will be those with low tariffs and/or insignificant domestic production. Given that the member countries have widely differing structures of tariffs, a uniform internal ASEAN tariff on a product will result in the member countries having widely different effective rates of protection on the product and on other industries using the product. Thus, the products that will likely be offered in the CEPT scheme will be those where the variation in MFN rates among the member countries is small, i.e., the products with low tariff rates.
As a complement to the ASEAN industrial cooperation program, the CEPT scheme under a product-by-product approach may also provide little if any additional progress. First, the current MOP on AIJV products is already 90 percent of the MFN rate; raising the MOP to 100 percent as the ASEAN-CCI Working Group on Industrial Cooperation has proposed will effectively set the CEPT at zero. The second and more important reason is that the current pre-approved list of AIJV products is not satisfactory or, as the ASEAN-CCI Working Group puts it, “meaningless” (ASEAN-CCI 1991, p. 6). Thus, in order for the CEPT scheme to have more impact on intra-ASEAN industrial cooperation, it is critical that the pre-approved list of AIJV products be meaningful. In this regard, the ASEAN-CCI Working Group recommends asking third parties to identify products that can be included in the AIJV list so as to “... sidestep the problem of excessive national interests in the determination of these products” (ASEAN-CCI 1991, p. 6).

**Tariff Harmonization Through CEPT**

The CEPT arrangement will, however, have a substantial impact on intra-ASEAN trade and investments if it is implemented on a broad sectoral basis because, when applied to all traded items of the member countries, the CEPT scheme will result in a more uniform structure of tariffs for intra-ASEAN trade. For example, if the MFN tariff rate on a product were 50 percent in one member country and 30 percent in another member country, a 50 percent MOP would result in a difference in effective tariff rate of 10 percentage points. If the agreed CEPT rate is 20 percent, both countries would grant preferences to meet this level, thereby requiring the high tariff country to grant an MOP of 60 percent and the low tariff country to grant an MOP of 30 percent. Indeed, the CEPT scheme implemented on a broad sectoral basis can serve as the framework for internal tariff harmonization and reduction leading to an ASEAN free trade area with the incorporation into the CEPT scheme of the PTA list and the elimination of the exclusion lists.

In the current PTA, a member country can erode the value of the PTA preference by raising the corresponding MFN rate. The CEPT scheme prevents this. Additionally, the CEPT scheme may induce the member countries to harmonize their external tariff rates in order to prevent excessive trade deflection.

The experience of the European Free Trade Association suggests that some external tariff harmonization or a narrowing of the range of external
tariff (but not a common external tariff) among the free trade area members would be needed to allow for the implementation of more flexible and liberal rules of origin. Given the wide tariff range in the ASEAN, the narrowing of the tariff range can be done in stages during the transition period towards the free trade area until the target maximum MFN rate (say at 20 percent) is reached at the start of the free trade area. External tariff harmonization through the setting of narrower MFN tariff bands per product grouping will make internal tariff harmonization through the CEPT much easier. Indeed, external tariff harmonization, coupled with the deepening of the margin of preference, will result in internal harmonization of the effective intra-ASEAN tariff rates.

The progressive reduction of the CEPT rates over time, together with the deepening of the margin of preference in the PTA and the eventual elimination of the exclusion lists, will eventually lead to the creation of a free trade area. It must be pointed out that a successful free trade area does not require that all tariffs on internal FTA trade be zero. For example, the most successful free trade area so far, the European Free Trade Association (EFTA), allows member countries to impose revenue duties (i.e., tariffs for revenue purposes) so long as they are not protective, which means that an equivalent duty is charged on both domestic and imported products. Nevertheless, the recourse to revenue tariffs should be minimized because it could be used as a loophole since tariffs charged on imports without competing domestic products can in principle be classified as revenue tariffs. Thus, to safeguard against protective revenue tariffs, EFTA required its members to open their actual and prospective revenue tariffs to the scrutiny of the other member countries (EFTA Secretariat 1966, pp. 75-77).

It must also be noted that the coverage of a free trade area need not encompass all of the traded items of each of the FTA member countries. Thus, Article XXIV of the GATT requires only that the FTA apply to "substantially all" trade between the partner countries in the FTA. EFTA, which excluded the politically-sensitive agricultural sector in its free trade agreement, was able to convince the GATT that the 90 percent coverage of traded items in intra-EFTA trade is consistent with the "substantially all" requirement of Article XXIV. In view of this, and considering the sensitive issues in agriculture, the attainment of an ASEAN FTA can be done in stages, perhaps with an FTA among industrial products first and then ultimately including agricultural products.
Eliminating Non-tariff Import and Export Restrictions

As effective tariff rates are progressively reduced, non-tariff barriers to trade will increasingly loom large as important constraints to increased intra-ASEAN trade. Non-tariff import and export restrictions are inconsistent with the workings of a free trade area. Hence, the creation of an ASEAN Free Trade Area also requires policy decisions to relax to non-significance or to eventually eliminate these non-tariff barriers to intra-ASEAN trade.

The percentage of restricted import items as of 1987 was approximately 16 percent for the Philippines and Indonesia but less than 5 percent for the rest of the ASEAN members (Dohner et al. 1988). The Philippines and especially Indonesia have continued liberalizing since 1987. Nonetheless, further efforts have to be made in all the member countries to phase out import restrictions to zero in intra-ASEAN trade (except for commodities where import licensing may be needed for security, moral, or public health reasons) in tandem with the program for the eventual elimination of intra-ASEAN tariffs.

The European Free Trade Association used an effective approach to eliminate the adverse trade effects of import quotas. In EFTA, the explicit or implicit import quotas as of a certain date (1959) were progressively relaxed (i.e., increased) by 20 percent every year thereafter. This resulted in the level of import quotas increasing nearly sixfold in just over a decade, thereby ensuring that the quotas became non-restrictive for intra-EFTA trade (EFTA Secretariat, 1966). ASEAN may fruitfully consider this approach.

Décalage

The process of eliminating intra-ASEAN trade barriers needs to take into consideration differences in levels of economic development and in structural demands of industries of the ASEAN member countries. Décalage, or the "getting out of step" technique, can be used to accommodate this by providing temporary support to member countries undergoing difficulties and temporary shelter for sensitive industries primarily by delaying tariff cuts (Curzon 1976). This technique has been used in the current PTA with the granting to Indonesia and the Philippines of a 7-year (instead of 5-year) period for phasing-in items in their exclusion lists in their PTA lists. The décalage technique can likewise be used to provide flexibility to the CEPT scheme. For example, all industries or selected industries in a member
country can be granted somewhat higher CEPT rates and/or somewhat slower reduction in the CEPT rates over a definite time period. The décalage technique, if judiciously applied, can provide the needed flexibility in the negotiations among the ASEAN member countries on the sensitive items in their lists, thereby smoothening the process of adjustment in the interim towards an ASEAN free trade area.

Safeguards and Escape Clauses

Provisions need to be made to allow member countries to temporarily derogate from some or all of their obligations under the free trade agreement under well-specified rules and procedures in case a member country faces a serious balance of payments problem or when an industry, sector, or region of the country faces unforeseen serious difficulties. In emergency situations like a serious balance of payments problem, a member country may be allowed to impose unilaterally temporary import surcharge or restrictions within well-defined limits and following ASEAN notification procedures. In cases of industrial, sectoral, or regional difficulties, ASEAN may need to specify clearly the conditions that would allow temporary derogations from the free trade agreement either unilaterally (under more stringent conditions) or upon approval of the ASEAN.

IV. Ensuring Success of an ASEAN Free Trade Area: Enhancing the Effectiveness of Intra-ASEAN Economic Arrangements

Relaxing Rules of Origin and Simplifying Documentation Requirements

Rules of origin are necessary in a PTA or FTA in order to prevent trade deflection when partner countries maintain different external tariffs. Without origin requirements, third country goods will enter the free trade area via the lowest tariff country and then move, duty free, to the higher tariff country(ies) in the FTA. As a result, the external tariffs of the high tariff member country(ies) become inoperative as a means of protecting domestic industries from third country imports.

Rules of origin, while necessary, exact additional transactions costs to the government machinery and private business sector in the member countries. Thus, it is essential that the rules of origin be as liberal, flexible,
and expeditious as possible, consistent with the objective of preserving the value of the trade preferences among the FTA member countries.

Currently, the ASEAN content requirement in the rules of origin is 50 percent, although it can be reduced to 35 percent on a case-by-case basis. So far, COTT has allowed only 21 eligible chemical products to have the reduced ASEAN content requirement. In looking at the reasons for the low utilization of PTA preferences in the ASEAN, the COTT-ITS (1991) highlighted the 50 percent ASEAN content requirement as one of the major factors.

Proposals have been put forward to relax the current ASEAN content requirement. COTT-ITS has called for a reduction from 50 to 35 percent across-the-board (COTT-ITS 1991). The ASEAN-CCI's proposal is to drop the content requirement to 20 percent initially and then raise it by 10 percentage points every three years until it reaches 50 percent after nine years (ASEAN-CCI 1991). Since a very low ASEAN content requirement will put at a competitive disadvantage industries in the high tariff ASEAN member countries, a possible compromise is to reduce the content requirement to 40 percent across-the-board.

The 40 percent ASEAN content requirement may be made more flexible by drawing from the innovative approaches of the successful European Free Trade Association (EFTA). One useful approach is to have a Basic Materials List which will include all industrial raw materials which are not produced in sufficient quantity or not at all produced within ASEAN. All items in this list can be imported from non-ASEAN sources and treated as though they were 100 percent of ASEAN origin as long as they have undergone further processing within ASEAN. The effect of this would be to increase the margin of preference for ASEAN manufacturers. Another approach that could be adopted is to base the 40 percent criterion on the f.o.b. export price rather than (as is sometimes done) on an ex-factory basis, excluding profits. The effect of this approach is that it would allow exporters to add their profit margin and overheads to the "ASEAN content" (see Curzon 1976).

The "process criterion" is another major approach used by EFTA as an alternative to the EFTA content criterion. Basically, the process criterion requires that products from non-EFTA countries should undergo sufficient processing within EFTA such that the goods produced will have a different tariff heading (at 4-digit HS codes) from the tariff headings of each of the materials processed. This is sometimes referred to as the "change of tariff heading" criterion. This criterion is an attractive alternative to the ASEAN
content criterion because it does not require detailed accounting records of non-ASEAN component materials and is hence less administratively costly to producers and exporters than the ASEAN content criterion.

EFTA has further refined the "change of tariff heading" criterion by specifying the processing carried out on non-EFTA originating materials that will confer EFTA originating status. This is because there are cases where there is a change in tariff heading despite relatively unimportant processing and cases where there is no change in tariff heading despite substantial processing. For certain sensitive sectors, the qualifying processes have been made more stringent. Finally, for complex products like engineering goods, producers were provided with alternative percentage rules that allow the use of third-country materials irrespective of their tariff classification within the stated percentage limits per product (EFTA Secretariat 1987, pp. 53-54). The result is a fairly detailed list of commodity groups (at 4-digit HS codes) and qualifying processes and/or EFTA content rules. Some analysts (Hurni 1989) consider the rules of origin in intra-EFTA trade during 1960-72 to have been more liberal than the rules of origin governing EFTA-EC trade after 1972. The tightening up was done primarily at the insistence of the EC. This suggests that depending on their definition and application, rules of origin may become instruments of protection rather than of trade liberalization. Care should be taken, therefore, to ensure that the rules of origin are not abused.

Aside from relaxing the rules of origin, EFTA simplified the documentation requirements over time. In principle, the customs officials or the recognized certification agency (usually the chamber of commerce) of the exporting country must provide the exporter with a certificate for tariff concessions or tariff-free status in the importing country. For exports of limited value, however, a simple origin declaration on the invoice by the exporter without the need for a certification would suffice for area tariff treatment. More importantly, "approved exporters," or exporters who make frequent shipments and who can provide the guarantees needed for the verification of the origin of the products, are allowed to issue the certificates with a one-year validity and covering all future deliveries during the period of validity (EFTA Secretariat 1987, p. 56). All these efforts are meant to reduce the transactions costs of intra-EFTA and EFTA-EC trading.

Considering the importance of the rules of origin and documentation requirements for the efficient working of intra-ASEAN trade, it is recommended that an ASEAN Expert Group be formed to study various comple-
mentary approaches to the current ASEAN content requirement and to recommend the workable parameters for implementation in ASEAN. A continuing ASEAN Technical Committee on Origin and Customs Matters composed of representatives from the member countries could be formed subsequently to set the specifics and timetable, monitor, and refine the rules of origin and other related matters as the need arises. This committee can be part of COTT.

**Rules of Competition**

A preferential or free trade arrangement brings out the issue of fair competition in trade. Specifically, one of the more difficult policy challenges facing the ASEAN member countries is to define the nature and scope of fair market competition for firms in ASEAN. In order to maximize the benefits from a preferential or free trade arrangement, the movement of goods and resources within the preferential or free trade area must be as free as possible, though there may be conflicting national interests and imperatives of the member sovereign states. The ASEAN member countries will have to spell out the rules of competition as intra-ASEAN trade intensifies and intra-ASEAN economic integration proceeds. While the EFTA and EEC rules of competition can serve as reference points for ASEAN, differences in economic structures and levels of living may mean that ASEAN will have to tailor its rules of competition to its own circumstances.

Five important policy areas will help determine the conditions of fair market competition in ASEAN, namely, export duties and drawback, government support or subsidies, public procurement, dumping, and right of establishment. Export duties have the effect of supporting domestic users against foreign users of the taxed product. An export duty discourages exportation; moreover, if the exporting country has some monopoly power in the world market of the commodity, an export duty reduces the domestic price and raises the foreign price of the commodity. Clearly, export duties are inconsistent with the dictates of fair competition in an ASEAN preferential or free trade area. Thus, it is necessary that export duties on intra-ASEAN trade be eliminated and prohibited. The member countries may, however, impose export duties on exports to non-ASEAN countries and, at the same time, undertake reasonable measures to prevent attempts at evading the export duties through export to another ASEAN country for re-export to non-ASEAN countries.
Drawback is the refund to exporters of duties they had paid on imported materials in their exports. Drawback is a common practice in the ASEAN and the rest of the world as a means of ensuring "free trade status" to exporters while at the same time protecting domestic import-competing industries through tariffs on imports. In an ASEAN preferential or free trade area, however, domestic industries will face unfair competition from exports of other member countries if such exports were to be allowed duty-free import of materials from non-ASEAN countries through the drawback system. Thus, drawback on intra-ASEAN trade is inconsistent with fair market competition and would have to be eliminated with the establishment of an ASEAN free trade area. Nonetheless, the member countries can continue granting drawbacks on their exports to non-member countries.

Governments tend to provide explicit or implicit subsidies to the economy as a whole or to specific sectors or regions. There are a number of alternative forms of such government subsidies. Government support to selected industries, sectors, or regions for economic or non-economic reasons is an inherent part of its internal economic policies. The support becomes an issue in free trade areas, however, when it leads to unfair conditions of competition between member countries or when it constitutes a barrier to trade. Thus, some government support activities can be considered to be consistent with free trade, a few may be directly inconsistent, and others may have potential impact on trading patterns or structure but vary in their relative importance.

In addressing the issue of government supports or subsidies, EFTA expressly prohibits a number of government interventions (e.g., subsidized export credits and export credit guarantees and overcompensation for indirect taxes paid), expressly allows a number of government support activities (e.g., credits, loans and guarantees, the long-term cost of which is fully paid by the beneficiaries, and general support to research), and evaluates others on a case-to-case basis to determine whether they "frustrate" the benefits of a free trade area (Curzon 1976, pp. 92-107). The same approach could be used by ASEAN. However, given the differences in circumstances of the ASEAN and EFTA member countries, the ASEAN lists of prohibited and acceptable government support activities will have to take into account the ASEAN context.

Preferential public procurement may not yet be an important policy area for the ASEAN because the limited budgetary resources of the member governments do not make feasible the use of preferential public procurement as a tool for strategic trade policy. Moreover, there are legitimate
reasons for favoring local contractors, e.g., accessibility in case of court proceedings, better after-sales service, etc. As in government support activities, ASEAN may follow EFTA's reliance on the "frustration of benefits" test (or determining whether the government policy, action, or regulation perceptibly diminishes the benefits that another member country can get from the free trade arrangement) in addressing as flexibly as possible the issue of public procurement.

Dumping constitutes unfair trade practice. To prohibit dumping in intra-ASEAN trade, the issue is how best to do this considering that ASEAN is not likely to be given supranatural legal powers in the near future. The problem of dumping in intra-ASEAN trade can probably be best handled through the powers of the member countries to impose countervailing actions against dumped products. To discourage dumping, ASEAN may require member countries to regularly notify the ASEAN Secretariat of anti-dumping actions taken against the exports of other member countries. ASEAN may also require the exporting country to accept duty-free the goods which its firms had exported to other ASEAN countries at dumping prices. The problem of dumping would probably be most troublesome with respect to intra-ASEAN trade in agricultural products.

The last important policy area of interest to ASEAN with respect to the rules of competition is the right of establishment or national treatment. The issue is, how far should member countries accord a "beyond most favored nation" status to citizens and firms of the other member countries in the context of encouraging intra-ASEAN trade and investments. The granting of national treatment to member countries in all economic areas is not inherent in a free trade area; indeed, it goes well beyond a free trade area and into an economic community. Nevertheless, in order to maximize the benefits from a free trade area, some degree of free mobility of human and capital resources may need to be allowed in ASEAN. The delimitation of the degree and scope of free mobility and the granting of national treatment will have to be carefully considered in internal policy consultations, discussions, and decisions of the member countries.

It is apparent from the above discussion that there are many technical issues and details that need to be firmed up in drawing the rules of competition in the ASEAN. It is recommended that an ASEAN Expert Group be formed to define the parameters and flesh out the details of the rules of competition suited for the ASEAN. A continuing Technical Committee on Non-Tariff and Technical Barriers to Trade composed of repre-
sentatives from the member countries could be formed subsequently to monitor and refine the implementation of reducing non-tariff barriers to trade. This committee can be part of COTT.

Reducing Technical Barriers to Trade

Technical barriers to trade refer to obstacles to trade arising from differing national product standards concerning the technical properties of the products themselves or administrative procedures such as tests, inspections, and certifications on the safety of the products. Product standards and testing requirements, if restrictive, are akin to import quotas and high tariffs in their constricting effect on trade. In fact, they can even be more pernicious because they discourage long production runs needed to attain economies of scale and substantially raise the costs of imports especially if the testing, inspection and certification requirements are unreasonably stringent.

Addressing technical barriers to trade is not easy because national differences in product standards and technical requirements may represent valid differences in national attitudes and tastes concerning product attributes like safety, performance, and accuracy, and in approaches to efficiency and convenience (Curzon 1976, p. 141). The road to harmonization of product standards may consist of a long series of small steps, initially stripping away highly protective technical barriers, thereby moving towards harmonization efforts.

There are a number of steps that ASEAN could undertake to reduce technical barriers to trade which deter increased market integration. First, ASEAN may develop information exchange networks for ASEAN producers on technical standards and regulations in the region. Second, ASEAN may require its member countries to notify the other member countries through the ASEAN Secretariat about new legislation and rules on product standards and technical requirements so that the other member countries can examine their impact on their exporters. Third, ASEAN may undertake a concerted and coordinated program of strengthening product testing, inspection, and certification bodies and agencies in the region which will include an agreement on uniform procedures on product testing, inspection and certification. Fourth, after strengthening and accrediting the product testing, inspection and certification bodies and agencies, the ASEAN members may agree on a mutual recognition of product tests, inspections, and certifications. That is, an importing ASEAN member country, say Thailand, would recognize the product test, inspection, and
certification conducted by an ASEAN certified body or agency in another ASEAN exporting country, say Indonesia, that has been done in accordance with Thailand’s product standards and technical requirements. Mutual recognition of product tests, inspections and certifications reduces the transactions costs to exporting firms and minimizes the danger that procedural requirements in product testing will be used for trade protection. Fifth, ASEAN may encourage private, voluntary product standards harmonization efforts within ASEAN. Sixth, ASEAN may participate jointly in international harmonization efforts of internationally recognized institutions and bodies instead of setting up technical standards for ASEAN only. This is because the ASEAN member countries are expected to have strong trade links with non-ASEAN countries even with the creation of an ASEAN free trade area. Finally, ASEAN may consider the feasibility of an ASEAN Patent Office, with national branches in each member country, in order to reduce the cost of patenting to ASEAN producers and inventors. The above-mentioned activities are being undertaken in economic groupings like the EFTA and EEC (see EFTA Secretariat 1987, pp. 73-87).

It will be useful for ASEAN to look comprehensively into the issue of technical barriers to trade in order to smoothen the process of intensified intra-ASEAN market integration. It is recommended that an ASEAN Expert Group be formed to formulate the program of harmonization of technical standards in the ASEAN. The continuing ASEAN Technical Committee on Non-Tariff and Technical Barriers to Trade proposed earlier would be tasked with continuously monitoring and refining the implementation of the program of reducing the technical barriers to trade.

**Intensifying Industry and Investment Cooperation**

One key factor for the eventual success of an ASEAN free trade area is stronger intra-industry trade, which can be encouraged through intensified industry and investment cooperation efforts linked with intra-ASEAN trade liberalization efforts.

Of the existing industry cooperation programs in ASEAN, the AJJV and brand-to-brand complementation are the most practical and promising. Their limited success so far strongly calls for an improvement in their implementation. In this regard, there have been a number of recommendations especially from the private sector which are presented in the Report of the Group of Fourteen on ASEAN Economic Cooperation and Integra-

Among the recommendations, the following are the most important: First, procedures for approving private sector proposals for AIJV and brand-to-brand complementation projects should be streamlined. The existing procedures have been so cumbersome, time-consuming, and ultimately expensive to the private sector that there are more intra-ASEAN joint ventures which have been established outside rather than inside the ASEAN industry cooperation programs. While the setting up of a pre-approved list of industries eligible for AIJV status is a laudatory step to reduce bureaucratic delays in the approval process, the current list is viewed by the private sector as insufficient (ASEAN CCI 1991, p. 6). Making the list more meaningful may require active participation by the private sector in the process of determining and deciding which products can be included in the list.

Second, considering that the MOP in the current AIJV is already 90 percent, it may be preferable to raise it to 100 percent, at least for some AIJV products, in order to minimize customs transaction costs to the private sector. In effect, the AIJV can be used as a pilot program for free trade in ASEAN for a limited number of specific sub-industries even if the overall free trade arrangement will still be down the road. Indeed, viewing the AIJV as a pilot program for free trade may make the program more meaningful. It will impel ASEAN to include existing intra-ASEAN joint ventures among the specified industries eligible for AIJV status. It will also reduce the pressure for any "bureaucratic protectionism" in the ASEAN approval process. And it complements—and can be integrated within—the CEPT scheme.

Third, customs procedures and documentation requirements in the granting of the tariff concessions should be streamlined. For example, the ASEAN-CCI calls for ASEAN governments "to expeditiously gazette the certificates of eligibility which accord AIJVs their MOP" (ASEAN CCI 1991, p. 7). The rules of origin discussed earlier are likewise related to this recommendation.

Fourth, national treatment should be given to AIJV products produced by the participating countries particularly for the purpose of complying with national domestic content requirements such that the AIJV products are treated for all intents and purposes as if they were produced in the consuming country or countries (ASEAN-CCI 1987, p. 34). It must be noted that the national treatment recommended here is different from the
national treatment as right of establishment discussed earlier which is related to investor’s equity.

While the current ASEAN industrial cooperation programs need to be improved to make them more effective in the interim, these programs, which rely on the granting of MOP, will become obsolete with the creation of an ASEAN free trade area. Thus, the likely future direction of ASEAN industry cooperation will be in investment promotion and investment regulation harmonization. In this regard, the existing ASEAN efforts at investment promotion will have to be deepened and expanded. Among these efforts, the one that has excited the private and government sectors most is the “growth triangle” concept such as the Johore-Singapore-Riau growth triangle which is a fine example of ASEAN governmental cooperation in support of private sector initiative.

There have been a number of suggestions for strengthening further ASEAN cooperation in investment promotion. Among these are the setting up of an ASEAN desk in each member country’s Board of Investments and joint promotion of foreign investments in the ASEAN. The most important proposal, however, is the promotion of ASEAN venture capital funds by providing national treatment to the projects supported by the accredited venture capital funds.

Another important area for investment promotion and coordination involves regional development programs for lagging regions in ASEAN. This could entail the identification of suitable areas to be designated as “ASEAN development zones” (ASEAN CCI 1991, p. 9) wherein ASEAN governments will set up the necessary economic and social infrastructure to encourage private industries. Schemes like build-operate-transfer may be instituted in these zones; coordination in investment policies, regulations and approvals may also need to be undertaken. The ASEAN Economic Cooperation Unit to be established in the ASEAN Secretariat can provide the necessary technical support in identifying the suitable development zones, preparing feasibility studies, and evaluating investment promotion and coordination measures, in conjunction with the national and regional planning bodies and investment promotion boards of the member countries.

Finally, ASEAN countries could look more closely into their investment incentives. Recent studies conclude that, overall, investment incentives in the ASEAN countries are comparable and that they have not been major or important determinants of investment flows. Considering that the elimination of tariffs on intra-ASEAN trade will reduce significantly the tax base
of a number of ASEAN countries, ASEAN member countries may need to reduce over time the fiscal incentives granted under their current investment promotion packages in order to prevent further erosion of their tax base.

**Strengthening Administrative and Monitoring Mechanisms**

The success of a preferential or free trade arrangement hinges on an efficient administrative machinery. Preferential trading benefits are meaningless to producers if the transactions costs of getting them are too high for the private sector. COTT-ITS (1991) points out that a key reason for the low utilization of PTA benefits is the poor implementation of the PTA, e.g., PTA preferences not granted or granted late by customs officials, PTA preferences not claimed by the private sector because of administrative problems, etc., and PTA being barely known in the private sector.

A stronger monitoring mechanism would have to be in place in the course of deepening intra-ASEAN economic cooperation. For example, a major shock in a member country may require temporary exceptions or a temporary *décalage* agreement to help the member country weather the setback. Constant review of the ASEAN initiatives may need to be undertaken to determine their continued relevance or sustainability in the context of a dynamically changing economic environment. Thus, there is a need to strengthen the ASEAN Secretariat especially in policy analysis, forecasting, and monitoring.

The experience of EFTA at monitoring is instructive. EFTA formed a Consultative Committee composed of individuals drawn from industry, labor, trade and other economic sectors acting in their personal capacities. The Consultative Committee enabled the policy, making body of EFTA to have direct contact with the sectors of the economy most affected by the economic integration process. While essentially a consultative body, the committee contributed to the refinement of the rules of origin, among others (Curzon 1976, p. 43). The successful experience of EFTA’s Consultative Committee indicates that there may be merit to forming a continuing committee in the ASEAN composed of selected individuals holding responsible private sector positions in various economic sectors in the ASEAN member countries. Although the ASEAN-CCI has formed a parallel structure with the ASEAN, and while there is strong linkage between the ASEAN-CCI and ASEAN, the creation of a Consultative Committee could provide an integral and continuing mechanism for
generating a wider range of views, advice, and proposals on the ASEAN initiatives on economic cooperation and integration.

V. Summary and Recommendations

Recent developments in the world call for a bolder and wide-ranging program towards the formation of a more cohesive ASEAN economic entity to meet the challenges and seize the opportunities in the world. In the area of trade and industry cooperation, the following courses of action are recommended:

1. Decide to create an ASEAN free trade area within a specified timeframe. This will define the end goal, approach and timeframe for the deepening of the preferential trading arrangement in the interim towards the ASEAN free trade area.

2. Deepen the ASEAN preferential trading arrangement
   * Institute the CEPT arrangement on a sectoral, not product-by-product, basis
   * Progressively lower the CEPT rates and deepen the MOP over time
   * Firm up the schedule of elimination of the exclusion lists
   * Use décalage judiciously to accommodate the special concerns of member countries and industries

3. Enhance the effectiveness of intra-ASEAN economic arrangements
   * Relax rules of origin
   * Lower the ASEAN content ratio to about 40 percent
   * Form an ASEAN Expert Group to study complementary approaches to the current ASEAN content requirement and recommend the workable parameters for implementation in ASEAN
   * Form a continuing ASEAN Technical Committee on Origin and Customs Matters which can be part of COTT to set the specifics and timetable, monitor, as well as refine the rules of origin and other related matters as the need arises
   * Reduce nontariff barriers
   * Firm up the schedule for the elimination of import and export restrictions on intra-ASEAN trade
   * Form an ASEAN Expert Group to study and specify the parameters for the ASEAN rules of competition
* Form an ASEAN Expert Group to study and formulate the program of harmonization of technical standards in the ASEAN
* Form a continuing ASEAN Technical Committee on Non-Tariff and Technical Barriers to Trade which can be part of COTT to monitor and refine the implementation of the program on reducing non-tariff and technical barriers to trade in the ASEAN
* Intensify industry and investment cooperation by improving the AJJV scheme in the interim and instituting cooperative efforts in investment and regional development promotion. The ASEAN Economic Cooperation Unit in the ASEAN Secretariat should also be operationalized. Study the granting of national treatment to private ASEAN venture capital funds and to selected trade and efficiency enhancing services and utilities sectors, e.g., shipping, consulting, and professional services, testing and warehousing services
* Harmonize investment regulations
* Strengthen administrative and monitoring mechanisms by strengthening the ASEAN Secretariat in policy analysis, forecasting, and monitoring and forming a Consultative Committee composed of selected individuals holding responsible private sector positions in industry, trade, labor, and other economic sectors in the ASEAN member countries
REFERENCES


I. Introduction

The world that ASEAN faces today is very different from that which it had witnessed at its birth in 1967. The Cold War is over. Geopolitical equations have changed dramatically. The European Community (EC) is set to turn Western Europe into a single market by 1992. It appears that a North American Free Trade Area (NAFTA), comprising the United States, Canada and Mexico, is in the offing. Perestroika in the Soviet Union, the breakup of the Soviet empire, and the streak of democratization in Eastern Europe have introduced new dimensions which render the picture even more complex.

The United States is riding high as a military power after the Gulf War, but its economic prowess has declined in relative terms. The world economy is no longer dominated by the U.S., now that Germany and Japan have also emerged as major players. North America, Western Europe and East Asia have become the growth poles of the world economy. ASEAN countries, too, have upgraded themselves economically, with Singapore joining the league of the Newly Industrialized Economies (NIEs) and Malaysia and Thailand being categorized as near-NIEs.

All these obviously have important implications for ASEAN. Now that the Cold War is over and communism is on the retreat, it is unlikely that Western powers would consider ASEAN as important as they did previously. ASEAN countries may have to fend for themselves without much external help from now on. Some ASEAN countries may even be graduated out of developed country preferential treatment, as they are well on their way to becoming developed or advanced developing countries themselves. Indeed, Singapore has already lost special preferences in the U.S. and will likely lose them in other developed country markets as well in the near future.

1. Main Contributor: Professor Mohamed Ariff, University of Malaysia.
ASEAN External Relations

It cannot be denied that ASEAN has gained much mileage internationally by putting up a united front vis-à-vis third countries. For one thing, ASEAN has attracted considerable international attention that has augured well for extra-regional trade and investment flows between ASEAN and the rest of the world. For another, ASEAN has extracted some "concessions" from its "Dialogue Partners" in terms of preferential access to their markets, technical assistance, and financial aid.

It may well be a new ball game altogether for ASEAN in the international arena from now on. ASEAN needs to change gears and adopt new strategies in its external relations. An attempt is made in this chapter to examine the changing external circumstances, with which ASEAN must come to terms, and to chart new directions which may serve ASEAN's interests in the 1990s.

II. Joint Approach: An Assessment

Extra-regional issues have always figured prominently in the ASEAN agenda. This was especially so during the initial stages when it was easier for ASEAN members to agree on extra-regional matters than on intra-regional issues. This attention to external economic relations which was a diversion helped foster ASEAN unity in a way.

ASEAN has evolved into what may be termed as a "collective bargaining force" vis-à-vis developed nations. Dealings with its Dialogue Partners, especially the U.S., Japan, and Australia, are clearly indicative of the prowess of the ASEAN joint approach ASEAN has gained much from the dialogues. For example, the U.S. was persuaded to extend its generalized system of preferences (GSP) to Indonesia which was kept out of the scheme because it was a member of the Organization of Petroleum Exporting Countries (OPEC). The rules of origin for the GSP exports from ASEAN were also relaxed so that "cumulative rules of origin" would allow greater regional content in export manufacturing. The so-called "competitive need" limits on GSP facility were revised upward in some cases.

ASEAN has also used its dialogue sessions to iron out bilateral trade and investment "disputes." Thus, ASEAN has appealed to the U.S. not to limit or withdraw foreign tax deferral for American companies in the region.

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2. The rules of origin have been particularly unfavorable to ASEAN countries, since goods originating in Indonesia, Malaysia, the Philippines and Thailand often go through Singapore, either in transit or entrepôt.
Likewise, the issue of bilateral trade deficits of ASEAN with the EC has been an important item on the agenda for the ASEAN-EC dialogue. In the same vein, ASEAN was able to persuade Japan to abolish the quota systems on several ASEAN products, including palm oil, animal fat, pepper, and margarine (Ariff 1981).

The joint ASEAN approach has also led to an increased flow of foreign aid and technical assistance into the region. Japan's offer of U.S.$1 billion in assistance to finance the ASEAN Industrial Projects (AIPs) merits special mention in this context. Discussions between ASEAN and its dialogue partners on a government-to-government basis have led to similar interactions at the private sector level as well. Notable examples are the establishment of the ASEAN-U.S. Business Council by the ASEAN Chambers of Commerce and Industry (ACCI) and the American counterparts, and the series of ASEAN-EC conferences bringing together government officials and businessmen from the two regions.

ASEAN countries have demonstrated their solidarity on issues of immediate interest to any particular member, as shown by the stance taken by ASEAN on Australia's international civil aviation policy (ICAP), which very seriously affected Singapore.4 ASEAN countries stood united when the issue was taken to UNCTAD V by Singapore and at the ministerial meeting convened to renegotiate ICAP in 1979 (Chia 1980).

ASEAN, which has played a constructive role in the North-South Dialogue, has always echoed the views of the Third World through the UNCTAD. However, ASEAN has distanced itself from the views of hardliners like India and Brazil. It has projected itself, much to its credit, as a group of moderate nations that can help narrow the North-South division on many international issues.

ASEAN acquitted itself very well in the Uruguay Round negotiations. Its members acted in concert through various stages ranging from early preparations to final negotiations. ASEAN sought and obtained United Nations Development Programme (UNDP) technical assistance to estab-

3. The U.S. tax changes limiting or withdrawing foreign tax deferrals - which allow the incomes of foreign affiliates of American companies incorporated overseas not to be subject to U.S. taxes until the incomes are distributed as dividends - have tended to throttle the inflow of U.S. capital into the region.

4. ICAP introduced cheap fares for travel between Australia and Europe with stop-over allowed in ASEAN countries only at high surcharges. Australia's Qantas and European counterparts, but not the ASEAN national airlines, were allowed to offer the new airfares.
lish an ASEAN-Multilateral Trade Negotiations (ASEAN-MTN) Project with UNCTAD as the executive agency in collaboration with the Economic and Social Commission for Asia and the Pacific (ESCAP). ASEAN countries have cooperated closely with one another in the identification of key issues to be addressed at the Uruguay Round, the formulation of ASEAN policy objectives in the MTN talks, and the planning of negotiation strategies. ASEAN has even come up with a game plan for achieving the ASEAN MTN goals.

ASEAN has learned from its joint approach towards the external world that unity is strength. While this is generally true, some caveats are in order. The world community will take ASEAN only as seriously as ASEAN regards itself. It appears that ASEAN's credibility has been eroded by the fact that very little of substance has been going on in the sphere of intra-regional economic cooperation. Moreover, ASEAN seems to have lost its geopolitical leverage in recent years in the aftermath of the end of the Cold War. Furthermore, as will be seen in the next two sections, bilateral, inter-regional, and international economic relationships have become increasingly complex in a changing world order, which might dilute ASEAN's bargaining power vis-à-vis the rest of the world.

III. ASEAN in the International Marketplace

The importance of extra-regional economic ties to ASEAN is obvious. Imports from non-ASEAN sources accounted for 86 percent of its total imports as compared with the 83 percent non-ASEAN share of ASEAN exports in 1989 (Tables 1 and 2). There is clear evidence which suggests that ASEAN is gravitating increasingly from the Atlantic to the Pacific (Ariff and Tan 1991). The Asia-Pacific share of ASEAN's total exports amounted to nearly three-fourths, while its share of ASEAN's total imports exceeded two-thirds in 1989. In particular, ASEAN's trade linkages with developed countries are strong and extensive, due to the complementarity of the economies of ASEAN vis-à-vis those of industrial countries. Among the Pacific countries, the U.S. represents the most important market for ASEAN exports (Table 1), while Japan remains the leading supplier of ASEAN's imports (Table 2). Of particular relevance is the growing share of the Northeast Asian NIEs in ASEAN trade flows. Their share of ASEAN exports has risen from 5.5 percent in 1970 to 9.8 percent in 1989 (Table 1) and that of ASEAN imports from 3.8 to 10.3 percent (Table 2) correspondingly.
Table 1
ASEAN-5 Exports by Destination, 1970-89
(Percentage of total exports to the world)

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<td>World (U.S.$m)</td>
<td>6,154.1</td>
<td>20,763.9</td>
<td>66,534.3</td>
<td>68,553.9</td>
<td>119,536.1</td>
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<td>United States</td>
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<td>16.9</td>
<td>20.3</td>
<td>21.6</td>
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<tr>
<td>Japan</td>
<td>24.0</td>
<td>27.0</td>
<td>26.8</td>
<td>23.9</td>
<td>18.4</td>
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<td>EC</td>
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<td>13.4</td>
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<tr>
<td>Australia</td>
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</tr>
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<td>New Zealand</td>
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<td>0.6</td>
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<td>NIEs*</td>
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<td>9.8</td>
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<td>China</td>
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<td>0.7</td>
<td>1.0</td>
<td>1.4</td>
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<td>Total Asia-Pacific</td>
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<td>72.1</td>
<td>70.2</td>
<td>75.2</td>
<td>73.1</td>
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<td>Other non-ASEAN destinations</td>
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<td>16.4</td>
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<td>Total extra-ASEAN</td>
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<td>84.3</td>
<td>83.3</td>
<td>82.2</td>
<td>82.6</td>
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<tr>
<td>Intra-ASEAN 5b</td>
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<td>15.7</td>
<td>16.7</td>
<td>17.8</td>
<td>17.4</td>
</tr>
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Notes:
- Hong Kong, Korea, and Taiwan.
- Excluding Brunei.

Sources: International Monetary Fund, Direction of Trade Statistics Yearbook, various issues.
### Table 2
**ASEAN-5 Imports by Source, 1970-89**
*(Percentage of total imports from the world)*

<table>
<thead>
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**Notes:**

a. Hong Kong, Korea, and Taiwan.
b. Excluding Brunei.

Sources: International Monetary Fund, *Direction of Trade Statistics Yearbook*, various issues.
ASEAN Economic Cooperation for the 1990s

Table 3

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Note:
a. Excluding Brunei.

Manufactures account for a growing proportion of ASEAN exports, rising from 11.0 percent in 1970 to 58.3 percent in 1989 for ASEAN-5 (Table 3). Another pertinent observation is that the intensity indices of ASEAN exports with respect to industrial country destinations for 1989 are lower than those for 1980, despite the substantial increase in ASEAN exports (Ariff and Tan 1991). The decline in the export intensity index (Table 4) suggests that the relative importance of ASEAN as a source of imports has dropped in these markets, presumably due to the inroads made by newcomers.

At the same time, the intra-industry trade of ASEAN, especially with developed countries (Australia being the only exception), has been growing in the 1980s, as shown in Table 5. This reflects the changing profile of the ASEAN manufacturing sector in general and its extra-regional linkages through investments and traded inputs in particular.

A recent market penetration analysis (Ariff and Tan 1991) has shown that ASEAN has been penetrating more and more successfully into developed country markets. However, there are important exceptions. For example, the import penetration ratio of ASEAN products in the Japanese market has declined. This observation is corroborated by the results of a shift-share analysis which shows that ASEAN has been losing out to China and the North-East Asian NIEs in the Japanese market (Herschede 1991).
Table 4

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Table 5

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</table>

Note:

a. Excluding Brunei.


ASEAN manufactured exports to developed countries and the Northeast Asian NIEs have regained their competitiveness in the late 1980s after having lost it temporarily in the mid-1980s, as shown by the results of a Constant Market Share (CMS) analysis (Ariff and Tan 1991).

Important changes are taking place in the international pattern of comparative advantage, with advanced countries vacating certain manufacturing activities which are duly taken over by developing countries. Product cycles, technological changes, trade interventions and direct
foreign investment (DFI) activities are all expediting the process of industrial restructuring and migration (Ariff 1990). There are indications that ASEAN is gaining new grounds in human capital-intensive and technology-intensive activities (Ariff and Tan 1991).

Structural changes, industrial restructuring, de-industrialization and demographic changes with aging population in developed countries are creating new opportunities for ASEAN. These opportunities are accompanied by new challenges, for the stage is getting crowded, with more and more developing countries adopting export-led growth strategies.

IV. Changing External Parameters

The world economy is undergoing significant changes that have important implications for ASEAN. The U.S. remains the world’s largest economy, but its influence on the world economy has weakened over the years, with the emergence of Germany and Japan as the new growth poles along with the U.S. Dramatic shifts in the pattern of comparative advantage, referred to in the preceding section, and the growing importance of intra-regional trade in East Asia and in Western Europe are also contributing to the changing global economic matrix.

In addition to these changes, the world economy is still afflicted by international imbalances in the balance of payments, although there are indications that these imbalances are narrowing. Moreover, the U.S. has a large budget deficit, and there are no quick solutions in sight. These macroeconomic imbalances in the industrial countries, of course, do not augur well for the world economy in the short term. Much would, however, depend on the extent to which these countries are willing and able to undertake policy adjustments which may well be painful. The manner in which the U.S. corrects its twin deficits will have important repercussions. Rapid adjustments will lead to a contraction of world demand, whereas gradual adjustments, while ensuring a soft landing, might spur protectionist measures. In either case, the implications are not favorable to ASEAN which relies heavily on the U.S. market.

However, the situation can be salvaged if Japan, on the other side of the Asia-Pacific equation, takes up the slack left by the U.S. correction process, which Japan can certainly afford to do. For Japan - unlike the U.S. - enjoys both internal and external surpluses. The negative external impact of a U.S. macroeconomic correction can be neutralized by a Japanese move in the opposite direction. It is heartening to note that Japan is beginning to do just
Table 6
Average Annual Growth of ASEAN-5’s Exports
by Trading Partner, 1970-89
(Percentage)

<table>
<thead>
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<th></th>
<th></th>
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</thead>
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<td>10.7</td>
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<td>16.4</td>
<td>11.5</td>
<td>12.5</td>
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<td>Japan</td>
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<td>16.6</td>
<td>7.3</td>
<td>4.7</td>
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<td>13.3</td>
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<td>New Zealand</td>
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<td>10.6</td>
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<td>Rest of the world</td>
<td>58.3</td>
<td>20.4</td>
<td>10.3</td>
<td>7.0</td>
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</table>

Notes:

a. Hong Kong, Korea, and Taiwan.
b. Excluding Brunei.

Sources: International Monetary Fund, Direction of Trade Statistics Yearbook, various issues.

This by stimulating domestic demand and liberalizing imports. Economic growth in Japan will translate itself into increased imports, if Japan mounts a major domestic policy reform that will include substantial deregulation.

Although the short-term prospects of the world economy are somewhat disturbing, with recession in the U.S. and the United Kingdom and deceleration of growth in Japan and a marked slowdown in Germany, the long-term outlook seems fairly bright, especially for the Asia-Pacific region. It is envisaged that the share of the Asia-Pacific in world output will increase to 48 percent by the year 2000 from 44 percent in 1981 (Rasmussen1988). Much of this increase is likely to come from the developing countries of East Asia, including ASEAN, whose share of world output is expected to more than double from 4.5 percent in 1981 to 10 percent by the 2000, due to a projected average growth rate of about 7.5 percent per annum (Table 8). The sources of growth under three possible scenarios are presented in Table 9.
By the turn of the century, developed countries are expected to be in the midst of their de-industrialization process, with manufacturing accounting for an increasingly smaller proportion of their gross domestic product. There is also evidence that the raw material content of manufacturing in advanced countries is on the decline (Hirata and Nohara 1989). This suggests that the scope for ASEAN to export its primary products in fully processed and embodied form is substantial. The de-industrialization process underway in developed countries should serve to complement industrial deepening in the ASEAN countries.

All these developments notwithstanding, it appears that economic regionalism is on the rise all over the world. There are numerous regional groupings in Latin America, South Asia, Australasia, and Africa which have yet to make an impact. Economic integration in the EC and the proposed North American Free Trade Area Agreement (NAFTA) to include the U.S., Canada, and Mexico are of concern to ASEAN because the
Table 8
Projected Growth Rates and Distribution of World GNP, Year 2000

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</table>

Source: Rasmussen (1985), Table 4, p. 154.

U.S. and the EC are very important to ASEAN as markets for its exports and as sources of foreign direct investments. In Asia, this trend has not taken the form of trading blocs per se, but Pacific Economic Cooperation (PECC) and Asia-Pacific Economic Cooperation (APEC) in which ASEAN countries hold membership are emerging to be important fora.

The worry is that the EC’s 1992 agenda for converting Western Europe into a single market would divert trade and investment away from the outside world including the ASEAN region. There are signs not only of the “deepening” but also “widening” of the Community. Austria and Sweden have applied for full membership and several others including Finland and Norway are expected to follow suit. At the same time, the idea of a European Economic Area (EEA), which is a single market embracing both
<table>
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</table>

Source: Lo, Fu-chen et al. (1989), Table 2, p. 100.
the European Free Trade Area (EFTA) and the EC, instead of a wider EC that would give the EFTA countries full membership, is being discussed. There are also fears that NAFTA will cause trade and investment diversions.

Amidst all these, the GATT (General Agreement on Tariffs and Trade) is relentlessly pursuing its goals of keeping the world intact by promoting the multilateral trading system. The Uruguay Round negotiations are continuing beyond the initial deadline set for December 1990. This extension signifies that the issues on the agenda are too complex and that the stakes are too high for all participating countries for the talks to be called off. Despite heavy odds, the Uruguay Round seems finally poised to enter the decisive phase.

V. Policy Implications for ASEAN

Without question, the external economic ties of ASEAN are much stronger than their intra-regional linkages in terms of trade and investment networks, which is by no means a bad thing. Undeniably, the export-oriented development strategy adopted by ASEAN countries in varying degrees has brought much progress as the strategy itself has made liberal policies both necessary and rewarding.

Increased exports have been accompanied by increased imports, partly due to the income-elastic nature of the ASEAN import demand, but also more importantly due to the high import content of ASEAN manufactures. The high import content is not necessarily undesirable as it has helped to render ASEAN manufactures internationally competitive. Nonetheless, the regional content of ASEAN manufactured exports has increased significantly. The Japanese MNCs in ASEAN, for example, are now sourcing a sizeable proportion of their intermediate inputs from within the region instead of importing them from their home country, following the sharp revaluation of the yen which has made such importations uneconomical.

The linkage between trade and investment is manifest. It is no coincidence that ASEAN countries' major trading partners are also the main investors in the region. Foreign investors tend not only to source their imported inputs from their home countries but also to export their output back home. The investment network of the MNCs extends beyond ASEAN, integrating ASEAN with the rest of the world and generating considerable intra-industry trade in the process. All this is symptomatic of the growing
globalization of manufacturing production and production processes. Since trade tends to flow through investment channels, it is imperative that ASEAN countries keep their investment corridors open. Equally important is the policy implication that trade policies are not independent of investment policies.

ASEAN countries will continue to benefit from the structural changes and industrial restructuring going on in developed countries and the NIEs. In particular, de-industrialization in the U.S. and Japan provides new opportunities which ASEAN countries can avail themselves of through industrial deepening.

ASEAN has reasons to be wary of economic groupings elsewhere. There are signs that Western Europe and North America are organizing themselves into closely-knit groupings, quite unlike ASEAN. Of particular concern is the accession of Greece, Spain, and Portugal to the EC. This has trade diversion implications for ASEAN, as these countries have comparative advantage in the manufactures of export interest to ASEAN. In the same vein, a reorganization of national quotas into a consolidated community-wide set of quantitative restrictions could also pose problems for ASEAN, as this might entail a tightening of restrictions against third-country EC imports (Naya and Plummer 1991).

However, there is really no basis for the fear that Western Europe and North America will transform themselves into "fortresses." For one thing, it is not in their own interest to isolate themselves from the rest of the world, as this would have deleterious effects on the dynamism of Europe and North America. For another, bloc formation is by no means an easy task, given the strong centrifugal forces at work. Thus, it is unlikely that the EC will become a single market come 1992. Also, the Single European Market will take a while to crystallize.

In any case, one should not exaggerate the risks of trade diversion. ASEAN’s trade in primary commodities seems quite immune to such risks, as these commodities have no perfect substitutes in these groupings. Resource-intensive manufactures, too, fall largely into this category. Likewise, the effect of the FTA arrangements of the U.S. with Canada and Mexico on ASEAN’s trade with North America is likely to be minimal for two reasons: (a) about three-fourths of the U.S.-Canada trade was duty-free even before the FTA agreement and many of the liberalized products do not compete with ASEAN exports, and (b) there is illegal trade between the U.S. and Mexico that would be legalized under the arrangement.
Be all that as it may, one must not underestimate the related danger of "investment diversion" for ASEAN. ASEAN owes its rapid economic growth in recent years to the huge inflow of DFI into the region. A free trade area in North America and a single market in Western Europe are likely to lure capital away from ASEAN, as many foreign investors do see opportunities arising from such configurations.

While the thought that the EC would become a fortress by 1992 is far-fetched, there is little doubt that the EC will become increasingly Euro-centric. The latter prospect seems almost inevitable with more and more West European countries knocking at the EC doors for admission and many East European nations abandoning their socialist ideology. There is also the likelihood of Eastern Europe drawing substantial investible resources at the expense of third countries and diverting the extra-regional imports of the EC. Nevertheless, the Eastern European countries are unlikely to pose serious problems for ASEAN. For one thing, the transition from socialist economies to market economies is not going to be smooth, which means that Eastern European countries will need time to put their houses in order before they can compete with other countries, including ASEAN. For another, ASEAN has clear advantages vis-à-vis potential East European rivals in terms of industrial experience and marketing expertise.

Far more dangerous than trade blocs in the immediate term is the possible trade war between the U.S. and Japan. If Japan is "forced" to strike a bilateral deal with the U.S., trade interests of third countries, including ASEAN, may be hurt badly, especially if Japan agrees to buy more American goods at the expense of ASEAN products (e.g., plywood). ASEAN may also get caught in the crossfire, given the Japanese involvement in its economy. To put it differently, ASEAN manufactures associated with Japanese equity may be viewed by the Americans simply as offshore Japanese operations and treated as such, which means that ASEAN's access to the U.S. market may be throttled.

Undoubtedly, ASEAN has benefited much from the multilateral trading system based on the principle of non-discrimination and open trading rules which represents the first-best option for all. ASEAN should not give up on the GATT system, even if the Uruguay Round results are disappointing. The multilateral trading system with the Tokyo Round benchmarks can continue, even if the Uruguay Round collapses. If the Uruguay Round can take the world beyond the Tokyo Round and pave the way for further rounds, ASEAN should have something to cheer about.
Meanwhile, ASEAN’s stake in the broader Asia-Pacific region is growing, as the world economy itself gravitates from the Atlantic to the Pacific. ASEAN countries must brace themselves to face various trade frictions as they intensify their commercial interactions with other Pacific Basin countries. Since regional problems require regional solutions, Pacific regional organizations like PECC and APEC can play a pivotal role. This observation underscores the need for ASEAN to participate actively in the Pacific process.

VI. Strategies for the 1990s

ASEAN members, as individual countries, have upgraded themselves economically during the last two decades, but ASEAN as a grouping seems to have lost some of its shine, partly due to its own inertia and partly due to exogenous factors. ASEAN has been dwarfed by the rest of the world, with many countries organizing themselves into groupings. In relative terms, ASEAN looks much smaller and weaker as a regional grouping than it used to be.

Under these circumstances, ASEAN may consider several options which include: (1) expanding the ASEAN membership; (2) deepening intra-ASEAN economic cooperation, (3) strengthening extra-ASEAN linkages, and (4) participating in wider regional groupings and forming coalitions with third countries. These options need not be mutually exclusive, and a judicious mixture may well be appropriate.

While a bigger ASEAN with additional members will certainly prop up the stature of ASEAN internationally, such an expansion at this juncture may present more problems than solutions. Arguably, ASEAN should first consolidate itself and put its house in order before it can expand. Besides, not many countries in Southeast Asia are really qualified or ready to join ASEAN. Nonetheless, ASEAN may consider the granting of “Associate Membership” initially to these countries as a prelude to full membership eventually. Much will, of course, depend on what such associate membership really entails, but there is little doubt that this will add some glitter to the image of ASEAN internationally.

The deepening of intra-ASEAN economic cooperation is imperative. ASEAN countries need to demonstrate definitively to the world at large that it means business, by adopting a holistic approach towards economic regionalism. The elimination of tariff and non-tariff barriers among ASEAN countries will lead to increased intra-regional trade and investment flows.
The ensuing competition among ASEAN countries should render their products more competitive internationally. Regular summits with a strong ASEAN Secretariat should place ASEAN under the spotlight in the world arena.

The joint approach towards third countries in general and the Dialogue Partners in particular has shown that unity is strength. Post-Ministerial Conferences (PMC) have proved to be a very useful external relations instrument for ASEAN. This notwithstanding, it is doubtful if the Dialogue Partners will continue to give so much attention to ASEAN. ASEAN has used the PMC as a forum for extracting concessions from the developed countries, but ASEAN cannot expect handouts anymore.

Although ASEAN has adopted a common approach in its external relations, it has failed to act as a unit. This failure seems to have cost ASEAN in terms of opportunities forgone. Bilateral agreements between the EC and ASEAN, for instance, have meant one signature for the EC and six signatures for ASEAN. By not taking a joint membership in APEC, ASEAN has allowed itself to be overshadowed by developed countries like Canada, Japan and the U.S. ASEAN may have missed the ASEAN-U.S. Initiative (AUI) bus. For it appears that the U.S. was wary of signing six different agreements with the ASEAN countries instead of a single agreement with ASEAN.

ASEAN could have acted more boldly, firmly, and imaginatively had it conducted its bilateral relations as if it were a single unit. The AUI is a case in point. ASEAN could have secured freer access to the U.S. market had it approached the U.S. as a single entity and taken the AUI seriously. ASEAN was simply reacting to a U.S. proposal, whereas Mexico and Canada had acted in a pro-active fashion. ASEAN would have gained much through the AUI. Theoretical and empirical underpinnings clearly suggest that benefits would have far exceeded costs (Ariff 1989; and EWC and ISEAS 1990).

ASEAN may seriously consider similar initiatives with Japan, the NIEs, and the EC. Although bilateralism is clearly inferior to multilateralism, a bilateral arrangement can be plurilateralized if the experience can be replicated. By entering into special trade relationship with its major trading partners, ASEAN will be able not only to penetrate their markets without having to suffer much trade diversion but also to prevent investment diversions that might otherwise occur due to group formations.

ASEAN may not subscribe to the view that the world economy is being divided into a number of trade blocs. And ASEAN may not share the fear that the multilateral trading system will collapse. While all this is reassuring
to ASEAN, it should not remain complacent. There is no guarantee that economic rationality will always prevail. ASEAN needs a "safety net" in case the world does degenerate into trade blocs. ASEAN needs to be insured against such risks. In this regard, ASEAN has the good fortune of being an integral part of the dynamic East Asian region. Unlike the other two growth poles (Western Europe and North America) East Asia remains unorganized. In this sense, it is in ASEAN's interest to have East Asia better organized and to play a major role in it.

The proposed East Asian Economic Grouping (EAEG) represents an "insurance policy" for ASEAN. This insurance policy will make considerable sense, especially if the insurance premium is low. Since the premium will depend largely on the mould of the organization, it is advisable to have a loosely structured EAEG that will serve as a consultative forum or a caucus. The trade bloc option for EAEG should only be exercised under exceptionally stringent conditions and only as a last resort. This option, however, should remain open, as it can usefully serve as a reminder to other groupings so that they will not blatantly abandon non-discriminatory multilateralism.

EAEG may be designed in such a way that it can promote healthy competition among its members and between East Asia and the rest of the world. EAEG should strive to promote the freedom of trade and resist protectionist pressures everywhere. All this means that EAEG must work within the GATT framework for the multilateral trading system, and not against it.

ASEAN should pay particular attention to developments in the Pacific Basin. There is unmistakable evidence showing that the world economy's center of gravity is shifting to the Pacific. ASEAN has an important role to play in the Pacific process. It should strengthen its present profile in both PECC and APEC, now that PECC acts as the "think tank" of APEC despite the differences in terms of membership and structure.

At present, ASEAN countries play only a passive role in APEC, and they are overshadowed by the major players like the U.S., Canada, Japan, and Australia. ASEAN countries even run the risk of being marginalized, unless they participate more actively and in unison.

APEC can be effectively used as a forum to sort out problems associated with trade and investment flows. APEC can also be used for macroeconomic consultations so that the adverse effects of policy changes in the developed countries of the region on the ASEAN economy are minimized and so that bilateral settlements among the advanced countries, especially between the
U.S. and Japan, do take into account the implications of such dispute settlements for ASEAN countries.

EAEG can also be seen as part of the Pacific process, as it represents the most dynamic countries of the Western Pacific rim. The U.S. and Japan are reportedly concerned that EAEG would negate APEC. A closer scrutiny, however, shows that such fears are really unfounded, for the perceived objectives of EAEG are different from and yet complementary to those of APEC. While APEC is somewhat Pacific-centric with a clear focus on intra-Pacific affairs, EAEG's main concerns are perceived to be global in nature. EAEG and APEC can work together for the common good of all Asia-Pacific countries.

ASEAN can do much on its own to promote better external economic relations for the benefit of its member countries. For example, ASEAN countries could (a) jointly undertake export promotion abroad; (b) step up efforts in the joint promotion of tourist trade, offering ASEAN packages to tourists; (c) sell the ASEAN region to foreign investors through joint investment missions and harmonization of their investment incentives so as to make the region attractive vis-a-vis other groupings; and (d) undertake reverse investments abroad by encouraging ASEAN private-sector joint-ventures in foreign countries.

It can strengthen its economic ties with immediate neighbors by fostering the development of "growth triangles." ASEAN can develop linkages with the Indo-Chinese states, the Northeast Asian NIEs, Papua New Guinea, Australia, and New Zealand through growth triangles. ASEAN can benefit much by entering into growth triangle arrangements especially with the Northeast Asian NIEs with which it already has extensive economic linkages.

ASEAN must not lose sight of the fact that multilateralism offers the first-best solution. Since trade is the lifeblood of the ASEAN economy, it is clearly in ASEAN's interest to keep the multilateral trading system going. ASEAN can use its own intra-regional economic cooperation, which is unquestionably a second-best option, as a stepping stone towards multilateral trade. In other words, while granting preferential tariff cuts among members, ASEAN countries should also lower their tariffs unilaterally. ASEAN countries should demonstrate to the rest of the world that they want to export their products to third countries because they want to import from them. This should help develop a symbiotic relationship between ASEAN and other countries and groupings.
ASEAN should help save the GATT system by playing an active and responsible role in GATT initiatives. ASEAN's role in the on-going Uruguay Round is commendable in that ASEAN countries have been acting in consultations with one another, offering significant tariff reductions. ASEAN countries have also been cooperating with others in the Uruguay Round negotiations. ASEAN is still too small to exert pressures or influences on international negotiations. It needs to join hands with others to make a tangible impact.

ASEAN should revitalize its dialogues with the major trading partners. There are signs that the PMC series involving ASEAN countries and the Dialogue Partners is losing its impetus in the wake of the rapidly changing geopolitical matrix, with the major players paying less and less attention to the ASEAN grouping. To earn their attention and respect, ASEAN needs to get its act together. ASEAN's external image can be refurbished greatly if ASEAN adopts a holistic approach towards intra-regional economic cooperation based on a clear vision.

ASEAN should also review its PMC strategies. Thus far, ASEAN Foreign Ministers have dominated the grouping's external affairs. Consequently, political and security issues have occupied the center stage of the PMC. With economic issues gaining primacy in the international arena, there is a need for ASEAN Economic Ministers to play a key role in the PMC. The effectiveness of the PMC is affected by the lack of homework on the part of ASEAN. There is no ASEAN Standing Committee to advise the ASEAN Ministers on matters relating to external economic relations. There is certainly a need for one. The Trade and Investment Consultative Committee (TICC), whose main task is to study the AUI proposal, may be broadened so as to provide intellectual and technical inputs on a wide range of external economic issues. Consultations with the private sector are crucial in order that trade and investment issues could be better vindicated at the PMC level. The ASEAN Chamber of Commerce and Industry's (ACCI) representation in the ASEAN External Economic Relations Committee is thus considered vital.

All this, however, should not amount to merely muscle flexing on the part of ASEAN. Confrontational measures are certainly not in ASEAN's interest. ASEAN should capitalize on its reputation as a group of moderate nations and remain pragmatic and down-to-earth in its external dealings.
REFERENCES


I. Introduction

The experiences of other regional groupings like the EC, NAFTA, and the Australia-New Zealand FTA have shown that a successful and meaningful regional economic relationship has to go well beyond the lowering of intra-regional tariff barriers. Border controls, border taxes, and various domestic policies affect international economic relations. At the current Uruguay Round of GATT negotiations, for the first time the emphasis is no longer on reducing tariff barriers but rather on non-tariff barriers and non-border measures such as trade-related investment measures (TRIMS), and trade-related intellectual property rights.

Additionally, domestic policies also affect trade and factor flows of capital and labor. Infrastructure developed by one country will have an impact on its own trade and investment flows and may also indirectly affect the flows of other countries. Moreover, the maintenance of both free trade and free capital mobility requires some coordination of domestic policies regarding inflation, exchange rates, interest rates, etc., as evidenced by the meetings of the heads of states of the large free market economies.

Consequently, three key objectives can be targeted for internal policy consultation: (1) the identification and removal of bottlenecks to ASEAN economic integration; (2) the facilitation of the process of future ASEAN economic integration by anticipating the kinds of policies that are likely to be conducive to it; and (3) the implementation of joint policies to enhance the economic growth of ASEAN.

This chapter will examine areas where consultation can prove useful, that is: (1) financial issues, (2) transportation and communications, (3) labor and non-bank services, (4) research and development, and (5) environmental policies. These broad areas of concern are normally considered to be

1. Main contributor; Professor Augustine Tan, Department of Economics and Statistics, University of Singapore.
purely domestic concerns. In all of these areas, differences among the ASEAN countries are large and may negatively affect integration of the ASEAN economies.

II. Finance and Macroeconomic Stability

There is much that the ASEAN members can do to bring about financial, fiscal, and exchange rate policies that will produce the macroeconomic stability necessary for economic integration. The experience of the European Monetary Union (EMU) illustrates this point very well. Exchange rate unification in the EMU is only sustainable when inflation rates of the member countries are convergent. In turn, the inflation rates mirror differential money-supply growth, budget deficits/surpluses as well as saving-investment balances. The ASEAN Economic Ministers (AEM) have already approved the regular publication of ASEAN’s macroeconomic outlook. This is an important step towards the macroeconomic coordination that is required if ASEAN wishes to achieve greater integration.

Saving and Investment

The world is facing a savings shortage, indicating that ASEAN will experience greater competition for investment funds. The reunification of East and West Germany, the opening up of Eastern Europe, the formation of NAFTA, the greater integration of the EC after 1992, and the liberalization of the Soviet Union will divert investment funds and create additional demands on global savings. In recent years, ASEAN has benefited from increased investments from Japan and the newly-industrializing countries (NIEs). The question is whether further investments will be forthcoming or whether the phenomenon was a temporary offshoot of the exchange rate realignment of September 1985. The so-called “flying-geese” pattern of technological development has been discerned, with Japan at the front, the NIEs following, and the ASEAN countries bringing up the rear. The problem has been that the output of the new investments brought by the geese has been largely exported to North America and West Europe. Although the more recent opening up of the Japanese market has partially alleviated the problem, ASEAN and the NIES need to explore new markets and, better still, create them.

In this regard, cooperation in a number of areas is possible. In the first place, ASEAN countries can harmonize their fiscal incentives for foreign
investments and can also jointly promote such inflows. For example, Singapore and Indonesia cooperated recently in investment promotion in Japan. Singapore’s Economic Development Board is also actively promoting foreign investments in Johore (West Malaysia) and Batam (Indonesia), the other two sides of the Growth Triangle.

Additionally, cooperation may affect domestic saving and investment. Table 1 shows that, with the exception of the Philippines, the ASEAN countries have high rates of gross domestic investment and saving. In the last three years, Indonesia and Thailand had rates of investment exceeding their averages for the past decade while Malaysia, Philippines, and Singapore had lower averages. Over the last decade, ASEAN, with the exception of the Philippines (19 percent) and Thailand (24.5 percent), had savings rates exceeding 30 percent. In the last three years, savings rates increased for all ASEAN countries except the Philippines. As a result of their strong savings performance, only the Philippines and Thailand are net borrowers (1 percent and 2 percent of GDP, respectively, in 1989).

Table 1
Saving - Investment Gap

<table>
<thead>
<tr>
<th>Country</th>
<th>1981-90</th>
<th>1988-90</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Savings¹</td>
<td>Investment²</td>
</tr>
<tr>
<td>Indonesia</td>
<td>31.8</td>
<td>30.2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>33.2</td>
<td>30.8</td>
</tr>
<tr>
<td>Philippines</td>
<td>19.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>42.3</td>
<td>42.0</td>
</tr>
<tr>
<td>Thailand</td>
<td>24.5</td>
<td>26.6</td>
</tr>
</tbody>
</table>


1. Gross Domestic Savings, percent of GDP.
2. Gross Domestic Investment, percent of GDP.

With the exception of Singapore (zero external debt), the external debt/GNP ratios for the other ASEAN countries worsened between 1980 and 1989. The debt service ratios (as a percentage of exports of goods and services), however, worsened for Indonesia and Malaysia and the Philippines but improved for Thailand (Table 2).
Macroeconomic stability depends to a large extent on the government’s fiscal performance. In 1989, three out of five ASEAN countries were in deficit. Singapore has had fiscal surpluses since 1961. Thailand had a budget deficit from 1980 to 1987; since then it has enjoyed a growing surplus. Malaysia’s budget for the 1980s has been in deficit but the deficit has been trimmed to more manageable levels in recent years. Indonesia has also been successful in reducing its budget deficit. With the exception of 1988, the budget deficit in the second half of the eighties has been less than that for the first half. Under the Aquino Government, the Philippines has also managed to trim its budget deficit. Last year, however, the Philippines’ budget deficit grew again to 4 percent of GNP (Table 3).

### Table 3
**Budget Surplus-Deficit**
(Percentage of GNP)

<table>
<thead>
<tr>
<th>Country</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>-5.5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-6.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>-4.0</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Because of the differential achievement in savings and investments and budget policies, the ASEAN countries have experienced divergent inflation rates, as proxied by GDP deflators. These averages, however, mask the considerable efforts made by Indonesia and the Philippines to bring down inflation rates substantially by the end of the eighties.

Table 4

<table>
<thead>
<tr>
<th></th>
<th>1980-1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>8.3</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.5</td>
</tr>
<tr>
<td>Philippines</td>
<td>14.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>3.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Source: World Bank, op. cit., Table 1.

Both Singapore and Malaysia have had managed floats since 1973. Thailand’s currency saw two devaluations in 1981 and 1984 and Indonesia had two substantial devaluations in 1983 and 1986. Monetary policies in ASEAN have been divergent. Singapore, Malaysia, and Thailand had relatively conservative monetary policies. Indonesia and Philippines, on the other hand, had more liberal policies, as evidenced by their high inflation rates; however, by the end of the eighties, they too had become more conservative.

Banking and Finance

All the ASEAN countries, with the exception of the Philippines, experienced considerable financial deepening between 1980 and 1989. Nonetheless, there remain considerable disparities among the countries. Indonesia eased financial regulations in June 1983 and October 1988. Since 1986, there has also been liberalization on the scope of allowed business activities. In 1988, licensing and branching rules were relaxed and public enterprises were allowed to place deposits with non-state banks. As a result of these measures, gross assets of the organized financial sector grew by more than
fourfold from 1983 to 1989. In Malaysia, deregulation since 1985 has allowed finance companies to participate in the interbank market while merchant banks can issue non-negotiable certificates of deposit.

From 1980 to 1984, financial liberalization measures of the Philippines reduced segmentation and entry barriers, while functional distinctions between different types of financial institutions were removed. At the same time, the scope of allowed activities was enlarged. In 1989, additional reforms lifted restrictions on the establishment of new banks and the opening of new branches.

Thailand has also introduced measures to increase competition and reduce concentration among commercial banks. In 1979, the Banking Act was amended to restrict ownership and asset concentration. Of all the ASEAN countries, Singapore probably has the most liberal financial system. Its well-developed financial sector is closely integrated with international financial markets. Practically every significant foreign bank has at least a representative office in Singapore. The extent of openness can be seen in the control of bank assets: 12 percent by local banks, 27 percent by foreign banks and 62 percent by offshore banks.

ASEAN members’ banks already function in each other’s countries. However, the process of capital market integration can be expedited by more liberal mutual granting of licenses. Intra-ASEAN financial intermediation will in turn promote and facilitate intra-ASEAN trade.

There already exists the ASEAN Swap Arrangement, which provides a standby credit facility to alleviate temporary balance of payments problems. There is also the private-sector-initiated ASEAN Reinsurance Corporation which is designed to enhance ASEAN capabilities in the insurance industry. Some effort has additionally been made to increase the use of ASEAN currencies for intra-regional trade and investment. Although not an outgrowth of ASEAN cooperation as such, all of the ASEAN countries belong to SEACEN (Southeast Asian Central Banks Research and Training Centre) and SEANZA (Southeast Asia, Australia, New Zealand Association of Central Banks), where ASEAN central bankers meet with their counterparts on a regular basis. However, as in the case of trade in other services, ASEAN cooperation in finance, transportation, and communications is limited to information sharing rather than market opening.

Also, efforts are being made by ASEAN member countries to promote the use of ASEAN currencies in intra-ASEAN trade. The maintenance of

free convertibility of ASEAN currencies in both current and capital transactions is essential to the development of intra-ASEAN trade in goods and financial services.

Taxation policies also need scrutiny and harmonization to facilitate ASEAN trade and investments. Currently, the main taxation issue under review is the area of taxation on banking institutions. The exchange of views covers the structures of the ASEAN banking and finance industry, governing laws and supervisory powers, tax regimes and tax treatment on various financial transactions. Guidelines on cross-border leasing taxes have also been established. But clearly, more work needs to be done in ASEAN tax policies and procedures.

Individually, ASEAN stock markets are very thin. This makes them volatile and more susceptible to speculation. The separation of the Singapore and Malaysian stock exchanges seems to be a step backward for ASEAN cooperation. Integration of ASEAN stock markets will not only give investors a wider menu but also facilitate the regional financing of industries.

In addition, ASEAN may consider giving its approval to the establishment of an “ASEAN Equity Fund” in which the private sectors in all ASEAN countries could participate as a source of risk and venture capital in the region. This would spur new opportunities, create ASEAN wide investments on large- and/or small-scales; and facilitate the twin ASEAN goals of pooling resources and markets. This Fund would complement existing institutions such as the ASEAN Finance Corporation and existing industrial programs such as the AIJV. The ASEAN Equity Fund could be funded internally by the private sector in ASEAN countries with contributions also coming from Northeast Asia and elsewhere. Investments with various combinations of ASEAN and foreign capital would be allowed, subject to the constraint that production be located in ASEAN countries. Additional incentives may be considered by ASEAN, such as providing national treatment to firms under this Fund.

**Infrastructure**

Each country in ASEAN has its own plans for improvements in infrastructure. There currently exists little or no coordination or consultation regarding this matter. Each country’s plan is focused on meeting the

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3. For more information on this area, see Anthony Chin, “Implications on Transport and Communications Infrastructure,” in this volume.
anticipated demands generated by economic growth and internal regional development. Progress has been made in fostering cooperation in transport and communication services, particularly shipping, air transportation and telecommunications. However, there is neither consultation nor coordination in the development of seaports, airports, and of road and rail transportation networks. At least three ASEAN countries are aiming to be the regional airhub! The proposed expensive Kra Canal Project will adversely affect Singapore and other ports south of the Canal; yet no consultation has ever been held on it.

Hence, the ASEAN countries have a lot to gain by coordinating such development efforts. ASEAN should also incorporate in its development plans anticipations and encouragement of greater intra-regional trade and factor flows. Member states can also benefit by sharing expertise and experience in infrastructure development. Coordination in setting common standards in transportation and communications will hasten the day when ASEAN industries can cater to a bigger and more uniform regional market. This will avoid the laborious attempts by the EC Commission in standardizing industrial products to facilitate economies of scale in production.

Labor and Non-Bank Services

ASEAN has had a fair amount of success in cooperation in tourism. An ASEAN Tourism Information Centre has been established to collect and provide relevant information and promote tourism activities in the region. ASEAN member countries have taken turns in promoting tourism in their countries through the Visit Indonesia Year and so on. Visit ASEAN Year 1992 has been declared with the close coordination of national tourist organizations. Some progress has also been made in transport and communications, especially in terms of information sharing. Growth in intra-ASEAN trade in services is conspicuous in some sectors such as entertainment, but has been less evident in other sectors such as banking. Little has actually been attempted by ASEAN to promote actively intra-regional trade in services. Yet, the service sector comprises a growing share of total output and trade and will likely play a key role in ASEAN's future.

Some preliminary measures to expand intra-ASEAN trade in services may be warranted at this time. One important step forward would be an improvement and coordination of data gathering efforts. Other areas where restrictions can be eased should be examined. Legal services, construction, and engineering services may be possible areas. Such steps
may help to alleviate serious bottlenecks for skilled workers in some of the ASEAN countries.

Additionally, some consideration should be given to means whereby the already large flow of workers between ASEAN countries can be facilitated and the irritations that sometimes develop assuaged. Cooperation in training facilities and in sharing experiences may help in this regard.

Research and Development

Another area in which ASEAN can benefit from further cooperation is in developing and sharing R & D facilities, not only in manufacturing but also in agriculture. This will avoid unnecessary duplication and allow the cross-fertilization of ideas.

The Twenty-Third Meeting of the ASEAN Committee on Science and Technology in September 1990 noted the successful completion of the Food Technology Research and Development Project in which 20 existing processes were improved and 11 new products were developed. The newly set up ASEAN Science Fund can do with much more money than the U.S.$50,000 from each member country.

Environmental Policies

The Fourth ASEAN Ministerial Meeting On The Environment in June of last year (Kuala Lumpur) decided to adopt a common stand for ASEAN on major global environmental issues. The Kuala Lumpur Accord also stressed the need for closer cooperation between the member countries in the pursuit of sustainable development. Six working groups were set up to study environmental problems in ASEAN. Closer cooperation and coordination between member countries will not only protect the environment but also help to renew/prolong ASEAN's natural resources.
The choice of machinery to further ASEAN'S objectives depends on the work to be done, especially in light of the fact that ASEAN was conceived largely for political objectives. Reflecting this, ASEAN Foreign Ministers created a loosely-structured decentralized committee system geared to political consultation and consensus-building. With the move towards greater economic cooperation at the Bali Summit in 1976, two major institutional innovations were introduced. Firstly, an independent ASEAN Economic Ministers (AEM) structure was created. Secondly, a central ASEAN Secretariat was set up. The machinery introduced at the Bali Summit was formalized at the second summit in Kuala Lumpur the following year and, except for overall expansion, this structure has remained to the present day, as illustrated in Figure I.

I. Essential Features of ASEAN's Organizational Structure

The essential features of the ASEAN machinery may be summarized as follows:

1. Primacy of ASEAN Foreign Ministers. This reflects the nature of ASEAN as a loose inter-governmental association for the essentially political task of inter-state cooperation. Even the creation of a separate economic ministerial structure to oversee ASEAN economic cooperation in 1976 did little to reduce the primacy of ASEAN Foreign Ministers within ASEAN's organizational structure.

2. National control. This reflects ASEAN's lack of supra-national objectives. As the "Panel of Eminent Persons" (1991) noted "member countries have wanted to make sure that they do not lose control of ASEAN at all times. To ensure this, a complex system of meetings, committees, and sub-committees has resulted, each with one member country at the helm."

1. Main contributor: Dr. Chng Meng Kng, Deputy Secretary General, ASEAN Secretariat.
Figure I

Present Structure

AHG

(Joint Ministerial Meeting)

Economic Ministers

AMM

Foreign Ministers

(Joint Consultative Meeting)

JCM

SEOM

SOM

Standing Committee

Directors-General

5 Economic Committees

Third Country Committees

Non-Economic Committees

ASEAN Secretariat

(Heads of Government)

Other Ministers

Sectoral Economic Ministers
3. Decentralization. This arose partly from the desire for national control. It also reflects the desire of member countries to maximize the participation of their officials in ASEAN affairs and generate confidence and goodwill among them, whatever the tangible fruits of their interaction. As the Heads of Government concluded at the Third Summit in Manila, "Over the past twenty years, the practical and tangible progress achieved in intra-ASEAN economic cooperation has been far less than expected. However, the intangible benefits of close and regular consultations among ASEAN economic officials, in creating a constructive and positive atmosphere for economic growth and investment in member countries, have been considerable."

4. Geographical dispersion. ASEAN intergovernmental bodies are geographically dispersed among member countries either on a permanent or rotating basis, and operate on an unwritten principle of equal sharing of the administrative burden. Secretariat services are generally provided by the host government with assistance from the ASEAN Secretariat. Resource inputs are generally provided by the host or other member countries.

5. A weak central Secretariat. This is a corollary of 2 and 3 above. Though established as a "central administrative organ" in 1976 amidst the euphoria of the Bali Summit, member countries have contrived to keep the ASEAN Secretariat small and its activities limited.

II. Organizational Issues and Measures

The ASEAN organizational structure has attracted much criticism, especially from those pushing for enhanced economic cooperation. Thus, according to the ASEAN Task Force in 1983, "The ASEAN organizational structure, as it exists today, does not facilitate the development of meaningful economic cooperation." More recently, the "Panel of Eminent Persons" reported that "ASEAN can be said to be headed towards a 'crisis' with regard to its command and control structure."

ASEAN's decentralized machinery, which has developed in a largely uncoordinated way, is characterized by an overlapping hierarchy and jurisdiction. Its central problem is one of achieving effective coordination among its diverse branches. While any discussion of organizational reform must take into account the overall structure, it is convenient to take up the issues at three levels: the ministerial level, the officials' level; and the level of the Secretariat, discussed below.
III. The Ministerial Structure

The most vexing issue at the ministerial level concerns the relationship between the Foreign Ministers and Economic Ministers. It is clear that for effective economic cooperation, ASEAN Economic Ministers and officials must be in the forefront of such cooperation. On the other hand, ASEAN is innately part of inter-state relations, and ASEAN economic cooperation must unavoidably involve issues of inter-state relations that require the attention of Foreign Ministers and their officials. Thus, for effective ASEAN economic cooperation, there must be close coordination between economic and foreign ministry personnel at both the national and ASEAN levels. However, within ASEAN’s decentralized organizational framework, the Economic Ministerial structure functions largely separately from the Foreign Ministerial structure. The decisions at the Second Summit in 1977 provide that Economic Ministers may report directly to the Heads of Government. But as the latter meet only very infrequently, Economic Ministers appear and feel subordinate to the Foreign Ministers by virtue of the latter’s mandated role as overall coordinator of ASEAN policies. Ambiguity over their proper jurisdictional domain has led to wasted effort and delays in the implementation of decisions. Trans-sectoral coordination is further hampered by poor internal coordination, or failures to forge a common national position within ASEAN member countries. This allows internal inter-ministerial differences to be projected to an ASEAN level, greatly complicating the task of coordination at the ASEAN level. Thus, for effective ASEAN coordination, attention has to be paid to effective coordinating mechanisms at the national level. Each country should as much as possible speak with one voice.

One area where the jurisdictional problems between the Economic Ministerial structure and the Foreign Ministerial structure is particularly acute is in ASEAN’s external economic relations, which in recent years have assumed a critical importance.

The Second Summit of 1977 gives ASEAN Foreign Ministers primary responsibility for external relations. Foreign Ministers and their officials have, thus, taken the lead in managing ASEAN’s external relations. The most important of these are the formal Dialogue Partner discussions, the highlight of which is the Post-Ministerial Conference (PMC), a forum which has assumed significance for participants beyond its ASEAN moorings.

In recent years, however, there has been a growing feeling in some ASEAN quarters, especially within economic ministries, that ASEAN
Institutional Structure

Economic Ministers and officials should play a more prominent and direct role in ASEAN’s external economic relations. And, if this is not possible within the existing institutional framework, such framework must be changed or an independent machinery should be created. Already, under the ASEAN-U.S. Initiative (AUI), ASEAN Senior Economic officials meet regularly with their American counterparts in a Trade and Investment Cooperation Committee (TICC) and the AEM also meets regularly with the United States Trade Representative, the last time being in a post-AEM meeting. Recommendations are now being made to create similar mechanisms with other ASEAN Dialogue Partners.

Such a development will dichotomize the whole machinery for ASEAN external relations into two separate structures, especially if an ASEAN Post Economic Ministerial Meeting along the lines of the PMC is created. However, even if a separate economic dialogue machinery, including an ASEAN PEMC, does not come about (and it may not, even if the AEM so wishes, as Dialogue Partners would rather meet with ASEAN countries on economic matters on an individual basis in fora such as APEC), the dynamics of the present situation would increasingly push ASEAN’s external economic relations into less (or non-) ASEAN-based fora such as APEC. ASEAN’s formal dialogue discussions, including the PMC, would then become increasingly political and weakened as economic issues drift into a different institutional orbit. If ASEAN is to preserve and strengthen the integrity of its external relations, such institutional issues must be addressed. In particular, ASEAN Economic Ministers and officials should be allowed to play a more active and direct role in external economic relations within a reformed ASEAN structure.

So far ASEAN’s efforts to improve trans-sectoral coordination have been largely exhortatory. Concrete measures involve the creation of essentially ad hoc mechanisms such as the Joint Ministerial Meeting (JMM) and Joint Consultative Meeting (JCM). However, such mechanisms are transitional solutions. In the longer term, the best way to combine the advantages of ASEAN’s present broad-based decentralized organizational structure with a greater degree of hierarchical coherence is to forge greater linkage at the top of its command structure. More frequent meetings of Heads of Government will help. But, ultimately, ASEAN should consider setting up an integrated Council of Ministers to which its main working senior officials organs such as the Senior Officials Meeting (SOM), Senior Economic Officials Meeting (SEOM), and Directors-General (reconstituted as a Committee of Permanent Representatives as has so often been proposed) can report.
IV. Senior Officials’ Level Structure

There is currently a degree of organizational disjunction between the three main groupings of ASEAN Senior Officials - the SOM, the Standing Committee/Directors-General (SC/DGs) and the SEOM.

The DGs do the actual work of the Standing Committee, which is a surrogate for the AMM. The SC/DGs is thus formally a higher body than SOM. However, SOM, which deals with political cooperation, generally comprises national officials more senior than DGs, and SOM reports not to the SC but to the AMM. SEOM, on the other hand, reports to a separate ministerial structure.

The SC/DGs is currently charged with the overall coordination of ASEAN activities and, in particular, the conduct of the formal dialogues at the officials’ level. As political and economic issues become increasingly interlinked, especially in external relations, the task of overall coordination is likely to become increasingly complex. The need for greater coordination between these three bodies has been recognized by the creation of the JCM comprising SOM, SEOM, and DGs. This is, however, a purely ad hoc arrangement. For greater organizational coherence, all senior officials bodies should report to a common and regularly-sitting parent body. As it does not appear possible to raise any of these three bodies into a superior body above the others, such a parent body can only be at the ministerial level, functioning as a ministerial body to cover over all sectors of ASEAN cooperation.

Within ASEAN economic cooperation itself, the machinery could also be streamlined. SEOM, which used to be a preparatory meeting for the AEM, was given formal status by the Third Summit in 1987. However, the five Economic Committees continue to report directly to the AEM rather than through SEOM. To reconcile the perceived need for greater centralization of effort with wide, broad-based participation, SEOM should be designated as the central, official-level body for economic cooperation. However, SEOM could create other subsidiary bodies in specific sectors or for special tasks either on a permanent or ad hoc basis to foster and force the pace of ASEAN economic cooperation. In other words, the existing Economic Committees would be dissolved and the different areas currently within their purview would be taken over by SEOM with the assistance of such subsidiary bodies as SEOM may flexibly create. Such an arrangement would allow the creation of new, coequal specialist groups in such areas as tourism, energy, commodities, civil aviation, etc., rather than forcing them into the present structure of five Economic Committees.
V. Reform of the ASEAN Secretariat

The ASEAN Secretariat was established in 1977 because of the perceived need for greater administrative and resource support for expanded ASEAN cooperative activities, especially as ASEAN moved from a consultative mode typical of political cooperation to a more functional, technical, and administrative type of activity implied by economic cooperation. Further, with the creation of a separate Economic Ministerial structure next to that of the Foreign Ministers, a central regional organ was believed to be useful for purposes of administrative coordination.

Despite expectations, the ASEAN Secretariat has not fulfilled its envisaged role either in terms of administrative coordination or technical support. The bulk of ASEAN activities continued to be transacted in a vast system of decentralized and geographically dispersed inter-governmental committees firmly under the control of member countries and drawing their administrative and technical support from national sources. As a result, the ASEAN Secretariat's role within ASEAN has become marginalized to the point of redundancy. There are three main reasons for this. One is the desire of member countries for wider participation of its officials in ASEAN activities, whatever the tangible benefits of such participation. Second, there is a lingering fear that a strong ASEAN Secretariat may usurp national control. Third, there is also concern that an expanded Secretariat may not generate benefits commensurate with the financial cost involved.

There now appears to be an increased recognition by member countries that for greater and more meaningful economic cooperation, ASEAN requires a strengthened Secretariat, especially in terms of research and general resource capacity to facilitate the needs of ASEAN economic cooperation. The major questions that arise in this regard are: (a) how large should the resources be?; (b) how are these resources to be organized?; (c) how is the Secretariat's capacity to be linked to other ASEAN organs?; and (d) what enlarged political mandate is necessary for the Secretariat to be effective?

Point (a) is not a major problem as the Secretariat can be expanded gradually and its cost-benefit effectiveness assessed. Regarding (b), to be an effective organization the ASEAN Secretariat must have a viable corporate structure and generate a results-oriented corporate culture. This is currently not possible given its present system of short-term national secondment. A move towards open recruitment (with some safeguards for a degree of national representation) in order to ensure personnel quality and commitment is therefore essential.
Questions (c) and (d) are linked and touch principally on the status and role of the Secretary-General. The Secretary-General should be given a higher status as Secretary-General of ASEAN rather than of the ASEAN Secretariat, as has often been proposed. More importantly, however, he should be given increased responsibility within ASEAN's major intergovernmental committees, and the mandate to exercise that responsibility. How long a leash are member countries ready and willing to give to the Secretary-General? There is a chicken and egg dilemma here. On the one hand, without a longer leash, member countries may not have the kind of effective Secretary-General and Secretariat it desires. On the other hand, member countries may fear that an "errant" Secretary-General, with too long a leash, may not observe "the unwritten ASEAN codes of conduct" (as the Panel of Eminent Persons puts it), and damage ASEAN relations. Such concerns have led member countries to be cautious regarding any expanded role for the Secretariat. However, after a quarter century of cooperative experience, ASEAN's base of common understanding and cooperative endeavors should be strong enough for some significant—if measured—steps to be taken in such directions.

VI. Basic Options

Various proposals have been made over the years to revamp and streamline the command structure of ASEAN and improve the effectiveness of its coordinating mechanism. However, ASEAN has chosen caution, preferring generally to make only marginal adjustments to the structure laid down in the Second Summit. This can still remain ASEAN's basic option. However, the Panel of Eminent Persons in its Report has proposed two other options. These are discussed in some detail as Options 2 and 3 below, not because of their specific merits or otherwise, but merely because they provide useful pegs on which to hang widely held sentiments or arguments. Figures II and III show the basic options proposed by the Panel of Eminent Persons. Option 4 in Figure IV presents another proposal based on an "ASEAN Council of Ministers" (ACOM) approach, which appears in an organizationally better option.

Option 2

ASEAN Heads of Government, constituted as a Supreme Council of ASEAN (SCA) become part of the working machinery of ASEAN. A Policy
Figure II
Panel of Eminent Persons (Option 2)

Institutional Structure

SCA

PCC

Supreme Council of ASEAN comprised of Heads of Government

Policy Coordinating Council comprised of Foreign Ministers

Ministerial Council on Security Cooperation

Ministerial Council on Economic Cooperation

Senior Economic Officials (SEOEM)

Economic Committees

Committee of Permanent Representative (CPR)

ASEAN Secretariat

Meeting once a year

Other ad hoc or Permanent Ministerial Councils

?
Figure III
Panel of Eminent Persons (Option 3)

AHG

Heads of Government
(Meeting once every 18 months)

AMM
comprised of Ministers
for ASEAN Affairs

Annual Ministerial Meeting

Committee of
Permanent
Representatives
(CPR)

Meeting six times a year

ASEAN
Secretariat
Coordinating Council (PCC) comprised of Foreign Ministers functions as a kind of executive arm of the SCA. The SCA can then form sectoral Ministerial Councils which will report to the SCA through the PCC. The day-to-day running of ASEAN would be vested in a Committee of Permanent Representatives (CPR) assisted by the ASEAN Secretariat.

Such an option appears to have the following detractions:

* It may not be in keeping with ASEAN political culture for Heads of Government, especially those who are also Heads of State, to engage at working level with what could be viewed as rather humdrum, and maybe even risky, diplomatic business. Heads of Government Meetings should more usefully be reserved as ceremonial occasions for cementing and demonstrating political cohesion.

* All Ministerial Councils, including Economic Ministers, will have to report to the Heads of Government through the Foreign Ministers. Economic Ministers would hence become even more subordinate to Foreign Ministers than at present. Such an arrangement is unlikely to engage the enthusiasm of Economic Ministers on whom depends the task for enhanced ASEAN economic cooperation.

* Each Ministerial Council will presumably have its chain of subsidiary organs. Thus, SEOM and/or Economic Committees will continue to meet under the direction of the Ministerial Council for Economic Cooperation. The CPR will, like the present Standing Committee, handle matters like third-country dialogues and oversee the work of Non-Economic Committees, and report to the SCA/PCC. Other ministerial councils will presumably set up their own subsidiaries. The end result would be a dichotomized ministerial structure, as, presently, the councils are linked up only at the very top. Who is to engage in the task of day-to-day trans-sectoral coordination? The CPR? It will be an impossible job.

**Option 3**

Option 3 is as neat and simple as a cut through the Gordian Knot. There would be just one simple, straight-forward decision making structure, and there would be no multiplicity of ministerial structures. The AMM will be comprised of one minister from each ASEAN country who will be the only authoritative voice from that country on ASEAN matters. These Ministers need not be Foreign Ministers. The CPR will do the day-to-day work of the AMM assisted by the ASEAN Secretariat.
With the exception of the ASEAN Secretariat, this structure would take us back to the pre-Bali Summit days of ASEAN. It certainly has the attraction of simplicity, but as a structure to support the task of enhanced economic cooperation it has basic shortcomings.

As the Panel seems to be aware of, this structure requires a very high level of national coordination. Besides, as Ministers in the various functional sectors, such as Economic Ministers, do not get to meet their counterparts in other member countries, it is difficult to see ASEAN cooperation in these areas getting very far off the ground.

As in the pre-Bali Summit days of ASEAN, the AMM/CPR can set up specialist Committees, expert groups, etc., on an ad hoc or permanent basis to promote functional cooperation. However, the AMM/CPR is likely to be overloaded, even with the assistance of a greatly strengthened ASEAN Secretariat. Economic and other such sectoral officials would report to, and be coordinated by, the AMM/CPR rather than their direct ministerial superiors. Such rigid and constricted machinery is unlikely to impart momentum to any substantive ASEAN economic cooperation process.

Option 4

It is proposed here that for effective functional cooperation ASEAN probably has to adopt a “Council of Ministers” approach to institutional structure. The proposal for an ASEAN Council of Ministers (ACOM) is not new, having been made, for example, by the ASEAN-CCI in 1981, the Task Force in 1983, and by various member countries on other occasions. Such a proposal is attractive because it combines broad-based participation with a coherent command structure. Figure IV presents one such structure as Option 4.

The institution of Heads of Government Meeting can remain largely as at present, perhaps meeting more often and informally as desired. Below the Heads of Government would be a Council of Ministers. As in the EC, the composition of the Council may vary depending on the matters discussed, but every minister could speak with the authority of his/her government, and all decisions would be Council decisions.

Under an ASEAN Council of Ministers umbrella, ASEAN Foreign Ministers, the AEM or any other group of ASEAN ministers can continue to meet as at present. However, as the decisions of all such ministerial meetings are Council decisions, there is greater need for national inter-sectoral coordination. That is, member countries will have to take ASEAN matters more seriously.
Institutional Structure

Figure IV
Option 4

AHG
(Needs of Government)

Council of Ministers

SOM
CPR
SEOM
CPA

Third Country Committees
Non-Economic Committees

ASEAN Secretariat

(Committee for Policy Analysis)
The AEM, as presently constituted, is actually a Council of Economic Ministers, though sectoral Economic Ministers do not meet with the full weight of the AEM. The institution of the Joint Ministerial Meeting (JMM) by the Manila Summit may seem to be a move in the direction of a full-fledged Council of Ministers, but was intended more as an ad hoc consultative mechanism between the AMM and the AEM. The JMM does not report to the Heads of Government. Since 1987 it has met only once.

Below the ACOM are the main operational groupings of officials such as

(a) SOM: for political and security matters;
(b) CPR: largely for third country relations, non-economic cooperation and political oversight of the ASEAN Secretariat;
(c) SEOM: for economic matters; and
(d) Committee for Policy Analysis (CPA) as a sort of ASEAN think-tank to help develop an ASEAN vision and a longer-term perspective on issues important to the progress and development of ASEAN cooperation. It is similar to the ASEAN Advisory Committee on Policy Studies (AACPS) proposed by the ASEAN Task Force in 1983.

The Council of Ministers and the various groups of senior officials will be assisted in their work by a strengthened Secretariat endowed with the requisite mandate and organizational, technical and manpower resources.

The main advantage of this option is that different groups of senior officials can report to their respective ministerial groupings; but as all ministers meet under the same umbrella, the main burden of trans-sectoral coordination would be transferred to member countries. Economic Ministers are the co-equals of Foreign Ministers in the Council of Ministers, and when Economic Ministers meet they can decide as authoritatively on economic matters as can Foreign Ministers on political matters.

The main resistance to this option would probably be from Foreign Ministers who could argue that as ASEAN’s primal, indeed overriding, function still remains the maintenance of regional inter-state harmony rather than the forging of functional cooperation (with the possibility that it could give rise to sharp contention), Foreign Ministers must still have a clear, final say on all ASEAN matters. An ACOM may, it is feared, overdilute the control of Foreign Ministers over ASEAN affairs. There may also be a feeling that Foreign Ministers, as the guardian of good inter-state political relations, should, to some extent, be insulated from contentious issues that may arise from economic cooperation. Putting all Ministers
under one umbrella may, it is feared, not provide sufficient insulation to Foreign Ministers.

Decisions with regard to institutional reform are thus not a mere technical matter but depend on ASEAN's view of its future—i.e., whether ASEAN is to remain largely a diplomatic club for confidence-building and peace-keeping or whether its political base can now be assumed firm enough for ASEAN to embark upon more meaningful economic cooperation. How member countries choose to proceed would depend on their assessment of ASEAN and, ultimately, their political decision in such regard.

The above is of course the briefest sketch of the structure of a Council of Ministers. Various refinements can be made to increase its coherence and acceptability. For example, the ACOM can meet as a “full Council of Ministers” with the Foreign Ministers as leaders of the delegation to replace the present AMM and to meet dialogue country ministers in the Post-Ministerial Conference (PMC). The AEM can, with the full authority of ACOM, initiate economic dialogues with third countries and even the creation of an economic Post Ministerial Conference.
I. Introduction

ASEAN has emerged as a force to be reckoned with on various fronts in international relations. A key question now and for the future is whether its optimal capabilities can be realized in responding to the aims originally established in the Bangkok Declaration, and to the other challenges brought about by external and internal pressures.

Ironically perhaps, the aims stipulated in the Bangkok Declaration that established ASEAN had more to do with economic, social, and cultural development, and less to do with politics. The emphasis was on "economic growth, social progress and cultural development." Yet, as has been noted in earlier chapters, it is the political image of ASEAN which has been at the forefront of international relations. Its tense security concerns during the 1970s in the face of ideological and military threats in the region and its preoccupation with the Cambodian problem during the 1980s, particularly in the United Nations forum, propelled the organization into the front line of political maneuvering. Paradoxically, now that ideological issues are retreating from the limelight and the Cambodian problem is showing a flicker of light at the end of the tunnel, the ASEAN raison d'etre is being impugned again. The emerging international economic ambiance is thrusting ASEAN onto another plane: threats of protectionism and the inception of new economic groupings, whether at the bilateral or regional level, will have important implications for ASEAN, both positive and negative. To

1. Main Contributor: Professor Vithit Muntarbhorn, Chulalongkorn University (Bangkok).
address the new situation ASEAN itself needs to become more active and cohesive in its internal and external operations. What, then, is to be the rationale for ASEAN's survival in the next decade and beyond?

A key answer is found in enhanced economic cooperation, which should lead to closer ties between the ASEAN countries, on the one hand, and between the ASEAN countries and other entities, on the other. The dynamics of such cooperation imply greater cohesion and harmonization of laws, policies, and practices between the ASEAN countries. As an aspiration, this is not totally new to ASEAN, although the progress has been slow. Will this development ultimately lead to integration, with supranational institutions and laws above the composite elements of ASEAN? While the minimalist may argue that this is premature for the present, the maximalist may well submit that comprehensive regional integration should not be ruled out in the years to come.

It is worth noting that from 1967 to 1976, very little happened in the region in relation to intra-ASEAN economic initiatives. That lacuna was rectified in principle at the Bali Summit in 1976 when the ASEAN heads of States met to adopt the Declaration of ASEAN Concord with a specific economic program of action, bolstered by the Treaty of Amity and Cooperation in Southeast Asia. In 1977, there came into being the Agreement on ASEAN Preferential Trading Arrangements. In addition, various projects to foster industrial cooperation were initiated, including the ASEAN Industrial Projects, ASEAN Industrial Complementation Projects, and ASEAN Industrial Joint Ventures. These programs were introduced as a result of three agreements: the Basic Agreement on ASEAN Industrial Projects 1980, the Basic Agreement on ASEAN Complementation Projects 1981, and the Basic Agreement on ASEAN Industrial Joint Ventures 1983. These economic initiatives have not proven to be as dynamic as expected, particularly during the 1980s when the ASEAN policy thrust was oriented more towards resolving the Cambodian problem. Many expectations turned out to be disappointments.

In order to improve the performance of ASEAN in the economic field, the Third Manila Summit, held in December 1987 in Manila, adopted another series of instruments to propel greater economic cohesion and other areas of mutual interest. The Summit adopted the Manila Declara-

3. Ibid.
4. Ibid.
5. For the text, see International Legal Materials Vol. XXVII, 1988.
tion which stated, *inter alia*, "To intensify efforts towards significant expansion of intra ASEAN trade, ASEAN shall adopt and carry out a package of measures for the improvement of the Preferential Trading Arrangements. Such measures shall include the progressive reduction in the number of items in the member countries' exclusion lists and the deepening of the margin of preference for items currently in the PTA. ASEAN shall also relax the ASEAN-content requirement in the Rules of Origin on a case-by-case basis. The standstill of non-tariff barriers (NTBs) shall be implemented and the rollback of NTBs negotiated as soon as possible. ... ASEAN shall accelerate sound industrial development within the region by making the ASEAN Industrial Joint Ventures Scheme more flexible, quicker to implement and more attractive to private investors."  

To attain these objectives, the Manila Summit adopted a Protocol on Improvements on Extension of Tariff Preferences under the ASEAN Preferential Trading Arrangements and a Revised Basic Agreement on ASEAN Industrial Joint Ventures, complemented by a Protocol to amend the 1976 Treaty of Amity, an Agreement for the Promotion and Protection of Investments, and a Memorandum of Understanding on Standstill and Rollback on Non-Tariff Barriers among ASEAN countries. The ASEAN Preferential Trading Arrangements program was rendered more effective by increasing margins of preferences and reducing exclusion lists, and the ASEAN Industrial Joint Venture program was rendered more attractive by increasing tariff preferences and the maximum equity participation in ASEAN.

Since the Manila Summit, some progress has been made, although muted in tone. More items have been introduced, and existing products have enjoyed a deepening of the margin of preference. However, the exclusion lists are still a stumbling block to freer trade, and impede real progress in liberalizing economic relations. There have been almost no signs of change concerning the standstill and rollback of non-tariff barriers. Even the promising AIJV program is not free from difficulties, as the response of the private sector to the AIJV program has been disappointing: only 21 approvals for AIJVs have been made to date, and only 14 are currently at any stage of development.

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6. Ibid., p. 603.
Clearly, much more commitment is required by all members of ASEAN to accelerate genuine economic cooperation on all fronts. Preparations for the forthcoming Fourth Summit in January 1992, thus, constitute a unique opportunity to galvanize ASEAN economic cooperation, taking stock of existing mechanisms and pushing for innovations where required. Given the short time available before the Fourth Summit, concrete proposals and ideas must be explored and analyzed to enhance closer economic cooperation based upon greater cohesion and harmonization of laws, policies, and practices, especially as regards the question of tariffs and freer movement of goods. These proposals must also offer projections for the period beyond 1992, in particular what should be expected in the following Fifth Summit, which we assume will be held in 1994. In this arena, other questions such as social development based upon a more elevated quality of life for the peoples of ASEAN and environmental concerns are most pertinent. Other factors of trade are also candidates for a freer flow, be they capital, services or persons. These have to be placed in the perspective of appropriate time phases, coupled with an effective process of monitoring and dispute resolution in the pursuit of the objectives set by each Summit.

This chapter seeks to understand the basis of ASEAN economic cooperation from a legal perspective, with a view to giving recommendations for the future. In Section II, we explore the notion of an ASEAN Economic Treaty, followed by a review of instruments for economic integration in Section III. Some concluding remarks are given in Section IV.

II. An ASEAN Economic Treaty

A key question facing the call for more cohesion and harmonization of economic relations concerns whether another treaty on economic cooperation should be placed before the Heads of State in 1992, and if so, of which type and characterization. On the other hand, there may be other alternatives, perhaps more flexible and less formal than a treaty, that should be explored in selecting the best framework for ASEAN.

Before addressing these issues, it is important to take stock of the treaty-making process which has affected ASEAN until now; areas of uncertainty may provide key lessons for any attempts to draft new treaties for the ASEAN grouping. As is implied by the word "treaty," what is meant is a binding international agreement, suggesting accountability of the States and other entities which become parties to such agreement. According to Article 2(1)(a) of the Vienna Convention on the Law of Treaties (1967), a
"treaty" is defined as "an international agreement between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation." Hence, a treaty is a legally binding instrument with legal consequences leading to state responsibility, should one party act in breach of it. Other terms which are at times used as synonymous with the term "treaty" include the terms "declaration," "protocol" and "charter." However, much depends upon the intentions of the parties drafting the instrument; the term "declaration" is sometimes taken to mean a non-binding instrument rather than a binding treaty. Agreements between international organizations and counterpart international organizations or states may also be tantamount to international treaties.

Interestingly, a question arose some time ago concerning whether the Bangkok Declaration is an international treaty. On a balance of probabilities, this is unlikely. A former Minister of Foreign Affairs of one ASEAN country supported this position by advocating that "of all the cooperative groupings today, it (ASEAN) is the only one that has no Charter." Moreover, the need for an ASEAN treaty in 1976—the Treaty of Amity and Cooperation—indicated that a more solid legal foundation for ASEAN was needed to supplement the Bangkok Declaration. The 1976 Treaty was registered with the United Nations Secretariat, thereby ensuring its status as a treaty. Although treaties are not necessarily required to be registered with that Secretariat, such registration gives additional weight to their status as international agreements. By contrast, the Bangkok Declaration was never registered with the United Nations Secretariat.

A similar position applies to the instruments signed in 1987 at the Manila Summit. The tone of the Manila Declaration was more aspirational than forceful; in other words, non-binding rather than legally binding. However, the other instruments such as the Protocol amending the Treaty of Amity and Cooperation in Southeast Asia; the Agreement for the Promotion and Protection of Investments; the Revised Basic Agreement on ASEAN Industrial Joint Ventures; the Protocol on Improvements on Extension of Tariff Preferences under the ASEAN Preferential Trading Arrangements; and the Memorandum of Understanding on Standstill and Rollback on Non-Tariff Barriers among ASEAN countries were all in-

tended to be legally binding. This is evident in several articles found in each instrument which indicate the binding force of the instrument, e.g., the condition that the agreement be signed without reservations (i.e., reservations implying non-acceptance of one or more of the articles of the treaty by the signing party), and that the instrument of ratification (i.e., not simply the process of affixing signatures but also the process of giving consent to the provisions of the instrument as legally binding) of each contracting party be deposited with the Secretary-General of the ASEAN Secretariat.

Interestingly, all the instruments referred to above were executed between the ASEAN countries themselves. An additional question arises whether ASEAN has the capacity to enter into agreements with other countries and organizations beyond ASEAN. If ASEAN has such capacity, it would indicate that ASEAN is recognized as an international legal person, with the potential for rights and duties on an international plane.

Thus, the essential question is: Does ASEAN have such treaty-making capacity, and is ASEAN an international legal person? Of note is the fact that it does not suffice for ASEAN, or any other international organization, to claim to have international legal personality by the mere fact of its existence. While, internally, ASEAN may wish to claim such personality and to initiate action in the name of ASEAN, e.g., by setting up the ASEAN industrial projects as a kind of joint ASEAN undertaking, the real test is an external and objective one, contingent upon how other international legal persons (e.g., states and other international organizations) recognize it as an international legal person with rights and duties at the international level. Generally, evidences supporting claims to an international legal personality include an organization’s treaty-making powers, the privileges and immunities granted to the organization by international legal persons, and the capacity to make claims for compensation.

Those who would advocate that ASEAN is an international legal person would resort to evidence such as the fact that ASEAN as represented by the ASEAN Secretariat has been granted privileges and immunities by Indonesia, on account of the 1979 Agreement between Indonesia and ASEAN relating to Privileges and Immunities of the ASEAN Secretariat. By this treaty, the staff of ASEAN working in Indonesia is accorded certain privileges and immunities. Moreover, the legal capacity of ASEAN is bolstered by the existence of various “aid” agreements between outside entities and ASEAN, e.g., an agreement between the United States and ASEAN to set up an Agriculture Development and Planning Centre in
Bangkok in 1980\(^1\) and an Agreement between ASEAN and UNDP concerning the training for satellite communications maintenance in 1982.\(^2\) More recently, various agreements have been signed between ASEAN and Canada along these lines.\(^3\)

On scrutiny, the evidence supporting ASEAN as an international legal person is equivocal. On the question of privileges and immunities, the sole agreement to accord such rights was between ASEAN and Indonesia—a member State of ASEAN—rather than between ASEAN and non-members. When ASEAN diplomats travel, they travel not on ASEAN passports but on the passports of the member country where they come from, and the privileges and immunities accrue to them on this basis. This is different from the case of the diplomats of the United Nations and the European Community who travel on UN and EC passports, respectively, with the implication that both the UN and EC are recognized as international legal persons.

On the question of treaty-making capacity, one may ask whether the treaties that exist in the name of ASEAN are between ASEAN \textit{qua} ASEAN and other entities, or between the member states of ASEAN and other entities. At the heart of the issue is whether a sole representative of ASEAN could sign on behalf of each member state of ASEAN. On important matters, there has been a tendency to have signatures from each of the ASEAN countries (implying six signatures) rather than one signature from ASEAN as an integral entity. This is in contrast with the European Communities which sign agreements with only one signature, i.e., that of the President of the Council of Ministers. The latter practice is again proof of the international legal personality of the European Communities \textit{qua} group, acting independently of its composite member states.

With this range of conflicting evidences, it may be submitted that ASEAN has a \textit{nascent} international legal personality rather than a full-fledged international legal personality. A major obstacle to its aspiration to

\begin{enumerate}
\item Intercountry Project for the Government of ASEAN Countries: Training in Domestic Satellite Communications Maintenance, 9 August 1982.
\item Memorandum of Understanding between the Government of Canada and ASEAN concerning the ASEAN-Canada Fisheries Post-Harvest Technology Project 1991; Memorandum of Understanding between the Government of Canada and ASEAN concerning the Canada-ASEAN Solar Energy in Drying Processes Project 1991.
\end{enumerate}
become a stronger international legal person is that it lacks an integrated position which would enable it to act independently of its members on the international plane. The ASEAN image is based on an intergovernmental association rather than an independent international organization. The fact that the member States are reticent about ceding a measure of their sovereignty to ASEAN is itself an indication that ASEAN cannot take independent initiatives which would confer upon it a distinct international personality, irrespective of the composite States. However, the march towards more cohesion and more harmonization of its activities should help to enhance its standing as an international legal person. This is a key reason for exploring a correlative instrument at the 1992 Summit to ensure closer relations and a higher profile for its international legal personality.

III. Instruments for Integration

Several initiatives which call into play the need for some kind of new modalities and instruments to be prepared for the 1992 Summit have come to fore. Proposal include an enhanced version of the CEPT and ASEAN FTA (discussed above), as well as the possibility of an ASEAN Treaty of Economic Cooperation (ATEC). With regard to the latter, two models have emerged. One emanates from the efforts of a special ASEAN working group explicitly addressing the possibility and form of an ATEC. A first draft of their study advocates a binding instrument eliminating tariffs on PTA products down to zero rate within one year after the treaty shall have come into force. Also suggested is the elimination of quantitative restrictions and tariff barriers on agreed product sectors, coupled with the reduction of exclusion lists and a rollback of non-tariff measures. The underlying aim would be to promote a free trade area, coupled with freer movements of persons. Compensation measures would be adopted to help those affected by the changes. The monitoring function would be conferred on the ASEAN Secretariat, and the treaty would be open to other states in the Asia-Pacific region who may wish to associate with the treaty.

The second initiative, tabled by the Philippines, advances the call for a treaty on economic cooperation aiming at an ASEAN Free Trade Area, the elimination of tariffs and quantitative restrictions on PTA products, the elimination of tariffs and quantitative restrictions in agreed product

sectors, the harmonization of exclusion lists, and the eradication of non-tariff barriers.¹⁵ AIJV negotiations would be accelerated, and there would be compensatory measures for those in need of concessions. There are also references to freer trade in services, persons and capital, and to cooperation in other economic fields. The ASEAN Secretariat would be the surveillance mechanism, but some safeguard measures would be permissible to ward off threats of injury.

The Philippine draft goes further than that of the Secretariat in that more elements are involved: goods, persons, capital, services and others. The tendency to have a legal instrument of this breadth would also mean a much more integrated ASEAN with greater expectations for cohesion and harmonization of existing laws and policies.

In addition to the possible adoption of an ATEC, there are alternative possibilities. From the above, it is evident that the various trends suggest the need to opt for some kind of binding treaty at the forthcoming Summit to cajole the ASEAN countries into a framework for more definite action at the local level. The divergence of approach lies in the difference between the "specific" approach as seen in the Indonesian proposal, which prefers to deal first and foremost with questions of tariffs and freer flow of certain goods, and the "general" approach, embodied in the call for a wider treaty setting into motion a free trade area and incorporating more elements than the free flow of goods. Thus, the other components of a common market such as freer flows of services, capital, and persons would be additionally introduced. Also revamped would be the ASEAN Secretariat whose role as a monitor would be reinforced by the treaty. However, none of the propositions cited refer sufficiently to modalities in making economic cooperation more meaningful to the quality of life of the people in the setting of social development and environmental protection.

In sum, it is submitted that certain choices are emerging in terms of treaty making:

- a general treaty with references to the multifarious components of a free market, i.e., goods, services, capital, mobility of persons and related mechanisms
- a general treaty with more than the components of a free market; i.e., not just goods, services, capital and mobility of persons, but also issues of equity, poverty eradication, resource reallocation, quality of life and environmental protection

- a general non-binding instrument, e.g., a general “framework” declaration, incorporating the components of a free market as mentioned, coupled with a program of action
- a general non-binding instrument with more than the components of a free market as mentioned, e.g., a broader “framework” declaration complemented by a program of action
- a specific treaty dealing only with tariff reduction with the CEPT or other means of lessening the tariff impediments, e.g., a Protocol appended to the existing treaties dealing with tariffs
- more than one instrument, e.g., a specific treaty dealing only with the tariffs issue, coupled with one of the other instruments mentioned

Given the short time available as the lead-up to the 1992 Summit, it is unlikely that the preparations for a comprehensive treaty will be possible; thus, the approach based upon the “general” treaties might not be viable at this stage. The more specific treaty dealing with tariff reductions, e.g., a Protocol on Tariff Reductions, should be initially considered. This could go hand in hand with a non-binding “framework” declaration, setting the agenda for the future and indicating a program of action. Prospectively, the general treaty for comprehensive economic cooperation should form the basis for the Fifth Summit, presumably in 1994. This treaty should be broadminded enough to address not only economic constituents such as goods, services, mobility of persons and capital, but also issues of equity and quality of life.

However, on the basis of the proposal for a specific treaty on tariffs set for the 1992 Summit, the treaty should aim to be “watertight,” i.e., to be forceful with a strong monitoring and evaluation mechanism. The treaty should incorporate the following components:

- implement the phased elimination of tariffs by using the CEPT approach, or the sectoral or subsectoral concept (the last being the most likely compromise) within ten years. Progress would be evaluated at Summits throughout the transitional period
- complement the elimination of tariff barriers by rolling back non-tariff measures
- upgrade the Secretariat to possess monitoring responsibilities, and supplementing its work, particularly on technical matters, by setting up a Tariff Council
- introduce a harmonized system of tariffs and customs nomenclature
- include the possibility of setting up a Development or Compensation Fund with contributions from the member countries to ease short-term structural adjustment
- allow certain safeguards to offset any negative impact at the national level, but with an explicit avoidance of the "6-x" formula
- limit exclusion lists to those allowed by the Secretariat and the Tariff Council for very specific reasons
- allow safeguard measures which constrain the free flow of goods only for a fixed period of time
- retain a degree of ASEAN content requirement in relation to AIV products so that a stimulus for some ASEAN participation is provided without being displaced by incoming investors from outside the region
- introduce a dispute settlement mechanism, perhaps by enabling the ASEAN Ministerial Meeting to be the forum for arbitration or to establish a subsidiary body to be such a forum

The Heads of Government should be encouraged to make an additional statement at the 1992 Summit in the form of a "framework" declaration, outlining the common needs of the region, e.g., freer movement of goods, capital, labor and services, as well as an agenda concerning the quality of life, poverty eradication and environmental protection. The declaration could also proffer a persuasive program of action on how to realize these aspirations in practice. The program of action could indicate the need for development funds in certain areas and ways of maximizing the potential for more coordinated action, e.g., greater cross-sectoral coordination between the various ministries at the national level and enhanced action on the part of the ASEAN Secretariat at the regional level.

These may pave the way for a binding ASEAN Charter on Economic Cooperation to be tabled at the Fifth Summit. Such a Charter could capitalize upon the various texts which have already been proposed for a treaty on economic cooperation. It would explore the wider field of
create a Council of Ministers embodying all the relevant ministers (foreign, economic, etc.) as a key instrument to drive ASEAN cooperation should be explored. The groundwork for this treaty could be delegated to the ASEAN Secretariat in cooperation with the other ASEAN mechanisms that exist.

IV. Conclusions

In conclusion, in terms of the instruments to promote closer ties among the ASEAN countries in the next phase, a two-pronged approach is recommended:

a) for the 1992 Summit, the aim should be to adopt:
   - a treaty on the elimination of tariff barriers (as identified above), i.e., a Protocol on Tariff Reductions (or its equivalent)
   - a statement by the ASEAN group in the form of a "framework" declaration coupled with a program of action setting the agenda for the future, including freer movement of goods, capital, labor and capital conducive to a free trade area, improved quality of life, poverty eradication, environmental protection and pooling of resources in response to common needs.

b) for the 1994 Summit, there should be tabled for signature an ASEAN Charter on Economic Cooperation embodying the broader vistas of a freer market and promoting social development in the region which will orientate the region towards a genuine ASEAN Economic Community.

This phased approach encompasses both the "dynamic" and the "pragmatic." Without such commitment, ASEAN may regrettably find itself diluting its own prospects and discover that time is no longer on its side. In that eventuality, ASEAN may find itself relegated to the periphery of international relations, if not obsolescence, in the face of new regional economic groupings.
I. ASEAN Industrial Cooperation

In industrial cooperation, three major programs, i.e., the ASEAN Industrial Project (AIP), ASEAN Industrial Complementation Scheme (AIC) and ASEAN Industrial Joint Venture (AIJV), have been adopted. Progress in all areas of industrial cooperation has thus far been modest.

The AIP designated one industry to specific countries. These industries were generally large-scale government projects. Among the five AIPs assigned to five original members of ASEAN, only the Indonesian and Malaysian projects are currently in operation. Projects of other ASEAN members have been changed several times and have never gotten off the ground. Problems encountered by AIPs include the lack of proper feasibility studies before the formal announcement of the projects, inadequate finance and technical support, and reluctance of some ASEAN members to commit themselves to their designated projects. Investors in the private sector in ASEAN have generally not been enthusiastic about participating in AIPs.

The AIC scheme was initiated in 1981. Its aim is to allocate different stages of vertically integrated industries among different ASEAN countries to reap the benefit of specialization and economies of scale. The first two packages of AIC involved the production and distribution of different automotive parts among ASEAN members. The first AIC scheme implemented in 1983 was not successful, as intra-ASEAN trade involving this package was very small. This first AIC was plagued with problems that included disagreements on product packages among the countries and the fact that automotive parts of different brands could not be used together. In view of the lack of success of the first package, the implementation of the second package by Malaysia, the Philippines, and Thailand which was to

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1. Main Contributor: Siomsak Tambunlertchai, Asian and Pacific Development Centre (Kuala Lumpur).
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be characterized by brand-to-brand complementation was postponed until 1988. The second AIC package was in fact reactivated by the interest of multinational automobile companies to divide different stages of their production in different ASEAN countries. Mitsubishi’s proposal in 1977 was the first of these, and this was discussed at the Manila Summit. To date, there have been seven complementation packages approved by COIME. With the prospects of closer economic co-operation among ASEAN members and the increasing interest of multinational automobile companies in relocating their parts and components production in the ASEAN region, the second AIC scheme could have stood a much better chance of succeeding than the first.

The AIJV scheme was proposed by the ASEAN-CCI in 1980 to promote intra-ASEAN investment. The Basic Agreement on the ASEAN Industrial Joint Venture was signed by ASEAN member countries in 1983. The major incentive to AIJV is the granting of tariff preference to AIJV products. Originally, the tariff preference was set at 50 percent of the existing tariff rate. The tariff preference was further extended to 75 percent in June of 1987, and to 90 percent since the last ASEAN Summit. The AIJV projects involve equity participation from two or more ASEAN countries. Other ASEAN countries may choose to opt out of any AIJV but their similar product cannot enjoy preferential tariff. Foreign investment participation is also allowed, with the maximum foreign equity participation originally set at 49 percent. This was later extended to 60 percent.

The AIJV scheme is considered to be viable since it was initiated by the private sector that actually makes the investment. It also allows for transnational corporations to be involved. But considering the limited number of projects that have entered the scheme to date, the scheme has not been so successful. Investors applying for AIJV projects have encountered excessive delays in getting formal approval which would entitle joint ventures to receive preferential tariff rates. Since the 1987 Manila Summit, a list of products that would automatically be approved as AIJV projects has been drawn up by the COIME to facilitate the granting of AIJV status. The list consists of products for which at least two member countries have expressed support. Tariff preference is given only to the participating countries in the initial four-year period. Non-participating countries will initially waive the right to grant and gain access to tariff preference on such products. The maximum waiver period is eight years. However, a non-participating country can enjoy the MOP granted by the participating
countries as soon as it extends the MOP itself after the first four years. The response of the private sector to this scheme has so far not been enthusiastic.

II. Towards an Improved AIJV Scheme

Although only a few investment projects are under the AIJV scheme, there are many intra-ASEAN investment projects with investors from two or more ASEAN countries. In addition to the bureaucratic delays, AIJV projects must compete with non-ASEAN suppliers; and for producers of goods to be sold outside ASEAN, the preferential tariff for intra-ASEAN trade is not meaningful. In light of the numerous intra-ASEAN investment projects in existence outside of the formal AIJV scheme, it is important to consider how useful the AIJV could be for industrial cooperation. If the AIJV scheme is still needed, how can it be improved to promote intra-ASEAN investment?

Despite its problems, the AIJV scheme can serve the purpose of encouraging the setting up of industrial joint ventures, the products of which are geared for the ASEAN market. It can also help to efficiently channel investment funds and entrepreneurial talents within the ASEAN region. Further, it can encourage joint investment efforts beyond those which would have occurred without the AIJV scheme. Thus, the scheme serves the purpose not only of market sharing but also of resource pooling which could be helpful for more efficient use of resources within the ASEAN region.

The AIJV scheme can be improved in several ways. As one of the major complaints of investors applying for AIJV status is the bureaucratic delay in securing an approval, the granting of AIJV status should be made automatic. At present, even with the existence of the pre-approved list of products, the investors involved still need to apply to respective participating ASEAN governments in order to obtain the tariff preferences. For products outside of the pre-approved list, the procedure is even more complicated. The investors involved will have to submit an application to the relevant national government agency which in turn submits it to COIME for approval. Next, they must get the participating countries to approve the granting of tariff preference which is presently set at 90 percent margin of preference (MOP) of the existing tariff rate.

Except for the incentive of 90 percent MOP, AIJV projects have no significant advantages over other joint investment projects, as foreign investors from outside ASEAN can also enjoy investment promotional
privileges in all ASEAN countries. One way to improve the AJJV scheme is thus to treat all intra-ASEAN investment projects as "national" projects which can enjoy the same rights and privileges as any investment project made by an ASEAN investor in his own country. As for the granting of tariff preferences, it could be separately considered, and could be tied to the newly-proposed schemes of Common Effective Preferential Tariff (CEPT) and ASEAN Free Trade Area (AFTA), as will be elaborated later. In other words, an investment project from any intra-ASEAN source should receive the same treatment as investment from a country's own national investors, and there should be no need to seek prior approval for such investment besides going through the normal investment process of commercial registration and obtaining permission to set up a factory in a chosen site. If investment incentives are needed, the investors can directly apply for such incentives with the investment promotion agency in the host country, which will give the same rights and privileges to the ASEAN investors as those given to its own nationals. In addition, to facilitate the process of providing information and granting incentives to intra-ASEAN investment projects, an "ASEAN Unit" or "ASEAN Desk" should be set up in the investment promotion agency in each ASEAN country to give services to ASEAN investors.

III. CEPT, AFTA and Industrial Cooperation

It is evident that trade and industrial co-operation are interrelated and that existing industrial co-operation schemes in ASEAN have used trade incentives such as the granting of tariff preference to promote such co-operation. In order to foster closer trade relations among ASEAN members, two parallel proposals have been made by Indonesia and Thailand on the Common Effective Preferential Tariff (CEPT) and the ASEAN Free Trade Area (AFTA). These two proposals are complementary and could be used together to achieve the objective of freer trade in ASEAN. More importantly, they could also be used to promote industrial co-operation and, hence, industrial development in ASEAN.

The CEPT scheme can also be used to facilitate the implementation of the AJJV scheme; in fact, the original CEPT proposal by Indonesia also includes the application of CEPT to AJJV products. As countries proposing a CEPT in a particular sector will import products in this sector with a specified CEPT rate from any ASEAN country, all AJJV products or all products manufactured by intra-ASEAN investment projects (subject to the ASEAN-
IV. Beyond a Free Trade Area

It is well known that an inherent difficulty in the implementation of a free trade area lies in differences in external tariff among member countries which could lead to excessive trade deflection, i.e., products from outside the FTA will enter through the country with the lowest tariff and then pass through other member countries without being subject to the external tariff rate of the other countries. Prevention of trade deflection will entail significant administrative costs. While a full-fledged customs union is not envisaged for ASEAN in the foreseeable future, it is important for ASEAN countries not only to reduce the tariff among themselves down to zero at a specified deadline, but also to attempt to narrow the differences in their external tariff. An earlier proposal was for something akin to a customs union to be adopted to harmonize the external tariffs among the four larger ASEAN members, i.e. Indonesia, Malaysia, the Philippines and Thailand. This should in fact be attempted at the same time that internal trade is gradually being liberalized in order to ensure the successful implementation of AFTA. Equally important is the harmonization of a customs tariff code and other technical aspects of customs procedures. ASEAN governments should work together to come up with a consistent system regarding customs rules and regulations.

Another area which may be more difficult to achieve is the harmonization of investment incentives among ASEAN members. At present, the ASEAN countries have differing incentives and conditions imposed on foreign investment. But a careful investigation into the details of the incentives given by the ASEAN countries would reveal that the differences of fiscal incentives given to foreign investors are not that great, and that some level of harmonization is not impossible. Each ASEAN member may want to maintain its own priority areas for foreign investment and also to
set out the necessary conditions, requirements, and restrictions to investment. But ASEAN governments should realize that as ASEAN approaches free trade status among member countries, a country with more stringent requirements towards foreign investment would not attract such investment, unless the economic, social, and political conditions in that country are superior to those of others. On the other hand, competition in giving incentives to foreign investors will prove to be a futile and costly exercise. Thus, it would be desirable for the ASEAN members to attempt to establish a common set of incentives as well as rules and regulations towards foreign investment, including investment from other ASEAN member countries.

As ASEAN moves towards economic integration, traditional small- and medium-sized enterprises (SMEs) in individual ASEAN countries would face more intense competition from three fronts. First, there would be rapid inflows of investment from transnational corporations in similar product lines, but with superior technology and management capability. Intra-ASEAN investment which could increase at a more rapid pace following the free trade agreement would be another source of competition. And finally, the formation of AFTA would enable the free entry of similar products from other ASEAN countries. While this competition from different sources represents trade creation and would lead to more efficient resource allocation in the long run, some industrial enterprises may have to go through painful adjustments. ASEAN industrial cooperation can seek to identify industrial sectors in different ASEAN countries which would most likely be affected by the process of economic integration, and find ways and means of assisting these sectors to make the necessary adjustments.

Indeed, with the rapid development of new technologies and the increasing globalization of production by transnational corporations, ASEAN countries will have to be prepared for rapid adjustment and continuously seek to upgrade their technological capability. Although ASEAN countries rely on transnational corporations for the development of their modern industrial sector, at present, most of the foreign direct investment projects in ASEAN still involve production processes with relatively simple technology. ASEAN members would like to see their industrial sector move towards more skilled- or technology-intensive or even capital-intensive industries as time passes. The enhancement of the absorptive capacity for technologies brought in by transnational corporations is also a matter of concern. ASEAN industrial cooperation in the future would therefore need to pay more attention not only to the adjust-
V. Towards an ASEAN Free Trade Area

In the ASEAN Summit, an announcement has to be made on the target date for ASEAN to achieve a full-fledged free trade area status. This announcement will have the effect of informing the world community that ASEAN is now ready to move forward.

It is, however, unlikely that all the details for the achievement of AFTA could be worked out and agreed upon at the ASEAN Summit. There are many issues which need to be agreed upon for the actual implementation of AFTA, including (a) the extent of tariff reduction, consistency among the existing PTA schemes, and extent of ASEAN content requirement; (b) the extent and timeframe for the reduction of non-tariff barriers; (c) the standardization of tariff procedures; and (d) necessary exemptions and safeguard measures including possible special treatment in some areas for member countries. In this regard, the details of various elements of FTA should be worked out and be tabled in the next ASEAN Summit (in 1994) for final decision.

In view of the importance of trade and investment in ASEAN, and to help in the preparation of various technical measures needed to achieve the FTA target, an ASEAN Trade and Investment Committee could be set up to provide specific recommendations to AEM on trade and investment matters, including the necessary measures needed to move towards FTA and an ASEAN Economic Community (AEC).

The ASEAN Trade and Investment Committee (ATIC) will be comprised of a number of senior economists from both government and private sectors in ASEAN. The ASEAN Cooperation Unit of the ASEAN Secretariat will serve as the Secretariat of ATIC and provide the necessary data and information. ATIC is to be financed jointly by ASEAN governments and ASEAN-CCI. Special study groups can be formed as necessary. Funding from the international community could be sought to support various study projects. One of the functions of ATIC is to recommend to ASEAN governments through AEM the actions necessary to be taken for ASEAN to achieve its FTA target.

Besides making recommendations on measures needed to be carried out for the achievement of AFTA, ATIC will also help ASEAN to identify
programs on further ASEAN economic cooperation. As industrial cooperation programs in ASEAN have extensively used tariff preferences as instruments, the need for such programs will lessen as ASEAN moves towards FTA. New institutions and programs will be needed to promote further industrial cooperation. Issues such as the harmonization of investment incentives and regulations, the distribution of investment projects among ASEAN members, the promotion of small-scale industries, the promotion of foreign investment in ASEAN, and the identification of regional projects (such as growth triangles and infrastructure development) could be studied to come up with specific recommendations. The rapid changes in world economic conditions which could affect the trade and investment of ASEAN and its individual members should also be closely monitored, so that recommendations on necessary adjustments could be made.

Finally, it should be pointed out that the institutional set-up of ATIC as proposed here is quite different from that of existing ASEAN Committees such as COTT and COIME. ATIC is comprised of representatives from both public and private sectors and has strong technical support from its secretariat. ATIC, which can be considered to be essentially a consultative body, has the important task of providing recommendations to attain an AFTA, and also of spelling out longer-term development issues relating to trade investment cooperation. As such, ATIC will work closely with all Economic Committees and also with a Non-Economic Committee such as the Committee on Science and Technology (COST), but will not duplicate the work of these existing Committees. The purpose of ATIC is to serve as a "think tank" for ASEAN on issues relating to the preparation of AFTA and to trade and industrial development in ASEAN. As such, the work of ATIC would be complementary to that of existing ASEAN committees. Recommendations made by ATIC will eventually be taken up by the ASEAN Summit, AEM and various official committees for implementation.
Supplement 2
Implications for Transport and Communications Infrastructure

I. Introduction

The realities of European economic integration and the emergence of the North America Free Trade Area have nudged ASEAN into a serious attempt at working towards closer cooperation. This is significant in that, for the first time, the agenda for the forthcoming Heads of State Summit will be dominated by economic issues. In the event that ASEAN-cum-EAEG emerges as the balancing force between Europe and the Americas in attracting investments, the demands on structural reforms and infrastructure development will be greater than ever. Already the rapid growth of many economies in ASEAN is exerting strains on infrastructure requirements such as transport, housing, sewage, and telecommunications. Governments are thus expected to spend more on infrastructural investments.

This paper begins by reviewing cooperation in transport and communications over the past decade and analyzing the problems that have hindered cooperation in the past. In the following section the implication of economic integration on transport infrastructure needs will be discussed. The final section suggests a strategy for consideration.

II. Recent Dévelopments in ASEAN’S Transport Sector

A review of the extent of cooperation within ASEAN in the area of transport and communications reveals that, despite the lack of a common transport policy, several noteworthy achievements have been achieved especially in maritime and air transport. This is not surprising, bearing in mind the geography of ASEAN. However, there seems to be a lack of progress in important areas such as:

1. the development of infrastructure in a coordinated approach (e.g., road, rail and ports);

1. Main Contributor: Anthony T.H. Chin, Department of Economics, National University of Singapore.
2. the harmonization of tariffs (e.g., port charges);
3. the removal of discriminatory practices (e.g., policies favoring domestic exporters and penalizing foreign imports);
4. the facilitation of the movement of goods and people (e.g., improving border crossings, gaining access to transport markets).

One reason for the lack of progress could be a lack of concerted effort. Another could be the issue of public expenditure where views of national sovereignty and the prioritization of expenditure may give rise to conflicts. As such the "operator" approach has become the focus of most projects embarked upon by ASEAN.

Economic development and growth exerts pressure on various sectors of the economy. The transport and communications sector is one such sector upon which the strains are beginning to tell. In many cities cracks are beginning to show. For others it is just a matter of time before the whole system breaks down. In addition to the high social costs (accidents, noise, and air pollution), road traffic congestion results in a loss of working hours and in freight not being delivered on time. Bottlenecks are not peculiar to roads alone. Congested skies, airports, and maritime ports are a common occurrence in many countries. In the final analysis it is a problem of capacity lagging behind demand.

Transport infrastructure ("hard infrastructure") consists of structures and systems which are usually large and generally publicly-owned or controlled by the government. The key role of any transport network development is to assist in the production, consumption, and distribution of goods and services. In recent years there has been a shift in emphasis towards developing "soft infrastructure" such as well-designed and distributed health and education systems. Hard infrastructure investments are usually large and lumpy, with long gestation periods for completion, and require large amounts of funds. The latter may skew the level of national investment for a certain period of time. For example, Hong Kong's airport project is expected to account for almost 1 percent of GDP per year once the project takes off. Taiwan's U.S.$300 billion investment in infrastructure over six years is expected to boost the GDP by 10 percent. Table 1 summarizes the regional expenditure in ASEAN and its impact on GDP. ASEAN would do well to carefully assess (through cost-benefit analysis) the impact of infrastructure development. Projects may have less impact on GDP growth if they have a huge import content, thus reducing real output by the value of the import.
Table 1

Summary of Regional Expenditure

<table>
<thead>
<tr>
<th>Country</th>
<th>Local currency (billion)</th>
<th>(U.S.$billion)</th>
<th>GDP boost per annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td>18,967</td>
<td>9.8</td>
<td>x</td>
</tr>
<tr>
<td>Other</td>
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<td>18.7</td>
<td></td>
</tr>
<tr>
<td>Subtotal</td>
<td>54,602</td>
<td>28.5</td>
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<td>Malaysia</td>
<td></td>
<td></td>
<td></td>
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Hard infrastructure development may be carried out in three main categories: major projects, minor projects, and maintenance. Major projects such as port, airports, and expressways usually attract much attention. Smaller projects such as feeder roads, additional berths, or a subsidiary railway line are usually less noticeable. However these projects very often account for about 50 percent of total government expenditure on infrastructural work. As the economy grows the need for maintenance tends to rise, providing an excellent opportunity for backward linkages to develop.
Spending on infrastructure in the past has been motivated by various reasons such as the provision of employment and as a counter-cyclical measure. In Singapore and Indonesia there has been a move towards stimulating private sector investment through interest rate adjustments and infrastructure investment on its benefits and merits. With or without the latest developments within ASEAN, infrastructure development will increasingly be an important source of growth. The focus is long term, and the requirements are such as to streamline the development of the transport network based on some Master Plan which coordinates and integrates transport development.

III. Bottlenecks in Cooperation in Transport Infrastructure

The brief review in the previous section seems to suggest that most infrastructure projects being undertaken are not coordinated at an ASEAN level. Rather, they are focused primarily on meeting the needs of economic growth and regional development within a country. Attempts in the past at fostering cooperation in transport and communications have achieved some progress in sea (in the area of shipping) and air transportation (access to airline facilities) and telecommunications. Cooperation in land transportation has made the least progress despite many projects in the pipeline such as the free flow of vehicles within ASEAN, the standardization of road design and of the weights and dimensions of vehicles used in international traffic, development of the urban rail system, and road safety.

The main factor which is apparently slowing down cooperation is the lack of funds and the lack of manpower to work on specific projects. In addition, the priorities of the various countries concerned are changing. A coordinated, let alone integrated, ASEAN transportation network is still a long way away. For example, inter-ASEAN air links may have been strengthened between capitals but it seems that at least three are vying to be the air hub of the region! The spillover effects of the SSDP are expected to enhance the northern Growth Triangle (northern Sumatra, southern Thailand, and northern Malaysia) but the impact on the movements of container cargo in other ASEAN ports is unknown.

As a starting point, ASEAN might wish to look at its strengths and weaknesses within each of the transport sectors. And having identified these, the process of cooperation can get started through embarking on investments which complement and enhance the economic growth of member countries. Tables 2, 3, and 4 give a summary of the strengths and
### Table 2
Port Sector

#### A. Strength of Administration

<table>
<thead>
<tr>
<th>Country</th>
<th>Institutional strength</th>
<th>Long-term development planning</th>
<th>Development policy setting</th>
<th>Inter-agency coordination</th>
<th>Inter-modal coordination</th>
<th>Regulation and control</th>
<th>Financial resources</th>
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#### B. Strength of Operations and Management

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<th>Country</th>
<th>Institutional strength</th>
<th>Management Information System</th>
<th>Financial Management and Control</th>
<th>Port productivity</th>
<th>Private sector (stevedoring, trucking, etc.)</th>
<th>Linking with inland transport system</th>
<th>Staff training system</th>
<th>Maintenance repair system</th>
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Table 2. (continued)

**C. Strength of Consultant Services (A: Engineering)**

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<th>Country</th>
<th>Coastal Hydraulic</th>
<th>Geotechnical/ foundation</th>
<th>Ocean/ marine structure</th>
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**D. Strength of Consultant Services (B: Others)**

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<th>Country</th>
<th>Development planning/feasibility study</th>
<th>Port operations</th>
<th>Financial management</th>
<th>Environmental assessment</th>
<th>Topographic/hydrographic survey</th>
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### E. Strength of Construction Industries

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<th>Construction plan/const. management</th>
<th>Construction equipment/floating craft</th>
<th>Financial resources</th>
<th>Soils improvement/foundation</th>
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### F. Areas for Investment Required

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<th>Domestic shipping</th>
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W : Weak  
A : Adequate  
S : Strong  
- : Information not available  
X : Required  
- : Not required

Adapted from Development and Management Profile of Transport Infrastructure in Asia and the Pacific, JICA.
Table 3
Road and Highway Section

A. Strength of Administration

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<th>Country</th>
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<th>Policy setting</th>
<th>Coordination among agencies</th>
<th>Financial resources</th>
<th>System for maintenance</th>
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B. Strength of Consultant Services

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<th>Pavement design</th>
<th>Maintenance</th>
<th>Bridge and structural design</th>
<th>Tunnel</th>
<th>Geological survey foundation</th>
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### C. Strength of Construction Industries

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<th>Financial resources</th>
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### D. Areas for Investment Required

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<tr>
<th>Country</th>
<th>Expressway construction</th>
<th>New construction</th>
<th>Surfacing/reconstruction</th>
<th>Local road improvement</th>
<th>Bridge</th>
<th>Traffic safety/control facility</th>
<th>Maintenance (including equipment and workshop)</th>
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W : Weak  
A : Adequate  
S : Strong  
X : Required  
- : Not required  

Adapted from Development and Management Profile of Transport Infrastructure in Asia and the Pacific, JICA.
### Table 4
**Railway Sector**

#### A. Strength of Administration

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<thead>
<tr>
<th>Country</th>
<th>Institutional strength</th>
<th>Long-term development planning</th>
<th>Development policy setting</th>
<th>Inter-agency coordination</th>
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#### B. Strength of Operations and Management

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<th>Country</th>
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<th>Management Information System</th>
<th>Financial Management and Control</th>
<th>Operational productivities</th>
<th>Marketing/services</th>
<th>Inter-modal coordination</th>
<th>Staff training</th>
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### C. Strength of Consultant Services

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<tr>
<th>Country</th>
<th>Development planning/feasibility study</th>
<th>Railway operations</th>
<th>Financial management</th>
<th>Environmental assessment</th>
<th>Topographic survey</th>
<th>Soils/foundation</th>
<th>Bridge</th>
<th>Tunnel</th>
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### D. Strength of Construction Industries

<table>
<thead>
<tr>
<th>Country</th>
<th>Construction plan/const. management</th>
<th>Construction equipment</th>
<th>Financial resources</th>
<th>Earthwork/track rehabilitation</th>
<th>Bridges</th>
<th>Plate girders/truss</th>
<th>Arch/suspension/box gird.</th>
<th>Tunnel/shield</th>
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### Table 4 (continued)

#### E. Areas for Investment Required

<table>
<thead>
<tr>
<th>Country</th>
<th>Track rehabilitation extension</th>
<th>Dieselization/electrification</th>
<th>Telecom./signalling</th>
<th>Locomotives repair/maintenance workshop</th>
<th>Wagon/repair/coach/repair/maintenance workshop</th>
<th>Rolling stock (loco. wagon coach)</th>
<th>Inland container depot</th>
<th>Staff training</th>
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<tbody>
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</tbody>
</table>

W : Weak  
A : Adequate  
S : Strong  
- : Information not available  
X : Required  
- : Not required

Adapted from Development and Management Profile of Transport Infrastructure in Asia and the Pacific, JICA.
weaknesses of a transport sector such that investment decisions can be made with a large degree of success. While such an exercise is useful to a funding agency, it can likewise be used to assess areas of cooperation between ASEAN member countries. It must be realized from the onset that such an evaluation will tend to be subjective, relative, qualitative, and extremely difficult. At best it should be used only as a guide, and then with care. The "strength" assessments are as follows:

1. WEAK: External assistance required;
2. ADEQUATE: Activity concerned seems feasible internally but requires help;
3. STRONG: Sector seems internationally competitive.

It is quite evident from the assessment that Singapore is set to play an important role in providing assistance in administration, operations, management, consultant services, and support services. One other aspect of assistance may be in the area of finance, taking advantage of its position as a major financial center. A showcase example of close cooperation is the Southern Growth Triangle.

IV. Some Implications of the New Order on the Development of Infrastructure

The demands of the new order on the existing transport network will be immense. Coordination and investment in transport infrastructure are but one aspect of the network. Timing is another. One would like to think of transport as a flow of goods and people within and across borders. Bottlenecks in a small sector could well lead to congestion, late deliveries, and loss of future contracts. Competition between ports and airports should make way for harmonization between modes across ASEAN. Some implicit assumptions will have to be made. For example, the Common Transport Policy of the Commission of the European Communities (transport, commerce and agriculture are the three common policies mentioned in the Treaty of Rome) summarizes the basic tenets as follows:

1. Transport infrastructure improvements will generate economic development benefits;
2. Minimizing restrictive regulations and fostering free competitive environment will improve the efficiency of the operators;
3. Improving journey times is regarded as similar to, or the same as, improving the provision of transport.
While one may agree or disagree with any or all of the above tenets, the development of an ASEAN transport master plan must be built upon some foundations. Guidelines should be forthcoming from some form of treaty which establishes the framework within which an ASEAN transport policy (ATP) could be based. The treaty should take stock of the present progress of economic development and attempt to shape future directions. The ground rules of such an ATP should leave ample room for the operation of the elements of a policy.

Should an ATP become a reality, member countries should not be slow to recognize the importance of intervention in transport infrastructure. The greatest fear would be that ATP might become a vague consultation procedure that would leave the choice of projects for study to the discretion of member states. The problem would be greater if each member state had a different approach to transport taxation, pricing and methods of allocating and controlling expenditure. One way of overcoming the problem is to ensure that all costs borne by a state can be fully recouped through taxation. In addition, users should pay fully in accordance with the benefits they derive from the infrastructure.

V. Recommendations for an ASEAN Infrastructure Network

There are challenges ahead, and since infrastructure development is a critical dimension in regional policies and in energy and land use policies, it has social implications. It could well bring transport policy into the forefront of ASEAN social and economic development. The following recommendations should thus be tabled for consideration.

1. Identification of Corridors of Movement

* The selection of modes and projects will involve a restructuring of spatial relationships. Corridors of movement of freight and people can be identified so as to assist the focusing on and investment in various routes. For example:

A. Maritime corridor
   a. Straits of Malacca-South China Sea
   b. Indonesia-Borneo-Philippines

B. Land transport corridor: road and rail
   a. Thailand-Malaysia-Singapore
C. Civil aviation hubs  
a. Bangkok-Singapore  
D. Telecommunications  
a. Economic centers of ASEAN  
* Identification of major transit routes and environmental problems which may arise. Improved efficiency in transport and emphasis on competition can produce social, economic, and environmental costs.  
* Forecast of economic activities which relocate as a result of changed accessibility surfaces and locational adjustments among large manufacturing and distribution firms.  
* Identification of bottlenecks/hindrances to movement, strengthening and development of major international links, links to peripheral regions, and missing links between existing networks.

2. Regional Body on Infrastructure Development and Policy  
* Coordination of projects and programs for the development of infrastructures that are of interest to the ASEAN as a whole.  
* Examination of every aspect of the communication network of interest to the ASEAN. This involves:  
A. Carrying out studies aimed at identifying infrastructure requirements;  
B. Development of criteria for the determination of interest in infrastructural projects (complementing ASEAN and national interests). One approach would be to reduce user cost and facilitate large movements of freight and passengers;  
C. Coordinating of national planning interest, evaluation, compensation, and financing of projects.  
D. Setting up of a permanent fund.

3. Common Policy on Infrastructure Investment and Pricing  
* The common policy on infrastructure should attempt to strike a balance between economic growth, environmental problems, quality of life, and realizing the full potential of modes and the integration of peripheral regions.  
* The overall economic cost of transport must be kept as low as possible.  
* Infrastructure costs must be allocated according to modes and users. Setting of prices to users and decisions on future investments must take into account the perceived economics of different modes.
* Establishment of a reporting system for infrastructure expenses and utilization.
* Development of a system of infrastructure-charging based on the social marginal cost of using the infrastructure.

This could be operationalized in the following manner:

**Phase 1:** *Identification of demand and cost.* This involves determining the total cost of transport infrastructure to be constructed and how this is to be apportioned. This could be done firstly, according to the different modes and other functions of the infrastructure. Secondly, allocation could be achieved according to different categories of users of the infrastructure.

**Phase 2:** *Development of an optimal transport network in accordance with an agreed master plan.* The role of railways, sea transport, and road network can be clearly identified through the development of