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IS AFTA STILL RELEVANT?

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The ASEAN Free Trade Area (AFTA) achieved a major milestone on 1 Jan 03 when the six original signatories (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) set tariffs on almost all manufactured goods and processed agricultural products at 0-5 %. (Malaysia excluded motorcars from this regime until 2005 to give its national motorcar producer another two years to prepare itself for a freer regional market). While the four new members of ASEAN (Cambodia, Laos, Myanmar and Vietnam) have another five to seven years to bring down their tariffs to this level the older six are committed to make theirs 0 % by 2010.

AFTA is more than a tariff-reduction regime. It is a composite project of ASEAN economic cooperation comprising three component programs: the Common Effective Preferential Tariff Scheme (CEPT –signed in 1992) governing tariff reduction; the ASEAN Framework Agreement on Services (AFAS –signed in 1995) for freer trade in services; and the ASEAN Investment Area (AIA –signed in 1998) governing investment liberalisation.

To support these three basic pacts a wide range of trade facilitation programmes has been adopted, the most notable being measures to reduce non-tariff barriers (NTB), streamline customs procedures and nomenclature; harmonise standards and mutual recognition of standards testing within ASEAN. These programmes should help to facilitate the freer movement of goods, services and investments within ASEAN, thereby creating a single regional market.

Efforts are being made to overcome difficulties in some areas over concerns to safeguard national industries and populations from dislocations arising from trade liberalisation, eg Malaysia's motorcar industry. More problematic are domestic regulations that permit NTBs to persist, such as resorting to the use of anti-dumping duties, which provide a ready protective mechanism against competing imports. These could prove attractive to governments as tariffs are brought down to zero. Concerted efforts to remove this hindrance to free trade are required at both regional and global level in the WTO.

There have been only limited commitments in services liberalisation despite two rounds of negotiations since 1995. The adoption of the "ASEAN minus-X" principle by which those members prepared to move faster will liberalise rules and regulations in various service sectors, should help move the process forward. AFTA is entering a more difficult phase of finalising the implementation of its unfinished agenda, particularly services liberalisation. It

is likely to be protracted because it will affect entrenched domestic interests. It is partly because of frustration with the slow pace of services liberalisation in AFTA that some countries, such as Singapore, have turned to bilateral free trade agreements with the developed economies.

Is AFTA still necessary?

The growing interest in bilateral FTAs by ASEAN member countries and the agreement by ASEAN and China to bring about a giant FTA between them have raised the question of whether AFTA has become redundant. To understand the implications of the new regional developments it is necessary to look at what AFTA means to both governments and businesses. AFTA has been crucial to the ASEAN countries as a magnet to attract foreign direct investments (FDI). The ASEAN governments believed that the large market potential of AFTA would attract FDI flows to the region, given the growing interest of investors in China and the “regional” logic of global capital. The increasing shift to flexible production methods and functionally integrated production chains meant that businesses, apart from looking for large markets, were also looking for regional spaces in which to set up regional production networks. AFTA offered the ASEAN countries the collective means to tap into this “regional” logic of global capital, particularly as an alternative to China, which also offered investors a competing “regional” site.

It is precisely because of this “regional” logic that AFTA will not become irrelevant. That is why foreign and domestic business groups are continuing to push for full implementation of AFTA. While initially aimed at attracting foreign investments AFTA is now also salient for domestic businesses. AFTA is a vital instrument in the process of building up competitive domestic businesses, since it offers them an expanded regional market, both to sell their products and to organise their production.

Bilateral FTAs

Bilateral FTAs, while offering some advantages, cannot replace a successful regional economic area. Bilateral arrangements represent potential building blocks towards global liberalisation, and are useful options when global and regional liberalisation face delays. However there is some incongruence between the bilateral FTA and the logic of global capital, which is increasingly to organise transnational regional production networks.

Hence in the US-Singapore FTA now being concluded, there is a provision for an “integrated sourcing initiative” to extend the juridical reach of the FTA to include the Indonesian islands of Batam and Bintan for electronics and information technology products. As final production of such goods in Singapore involve extensive use of components produced in Batam and Bintan, strict rules of origin under the bilateral FTA would effectively exclude Singapore-made final products from the US market unless crucial portions of Singapore’s production space outside Singapore are included within the ambit of the FTA. This is ironic since electronics and IT products from both Singapore and Indonesia already enjoy free access to the US under the WTO Information Technology Agreement of 1996.

Since regional production networks already operate in key sectors like motorcars, automotive components, electrical and electronics industries this issue will become relevant for other ASEAN countries contemplating bilateral FTAs. Thus while bilateral FTAs offer the ASEAN countries both political and economic benefits through locking in market access,

the trend towards the regionalisation of production suggests that AFTA remains a highly salient project.

ASEAN-China FTA

What is the salience of AFTA in the context of the ASEAN-China FTA? Here the role of AFTA needs to be considered in the light of the two key concerns of ASEAN governments with regard to China: the diversion of FDI from ASEAN to China, and the market displacement effect of cheaper imports from China. When the ASEAN-China FTA comes into effect China could continue to displace ASEAN as a site for investment because of its size, internal complementarities and lower labour costs. Investors may prefer to locate in the more attractive China region knowing they are also assured of preferential market access to ASEAN under the FTA. Thus an ASEAN-China FTA would weaken the salience of AFTA as a regional space for investment. While the converse is also possible, that investors would prefer to locate in ASEAN and be able to enjoy preferential access to the China market, investor perceptions will determine which outcome prevails. Today ASEAN faces uncertainty on two fronts: the future of the Indonesian reform process and the spectre of regional terrorist networks, both of which colour perceptions of ASEAN negatively to China's advantage.

For these reasons, ASEAN governments are expected to proceed cautiously on an ASEAN-China FTA notwithstanding the benefits to be gained by their national economies from the China market. Speedy implementation of the next phase of AFTA will allow ASEAN to consolidate its position as a regional investment and production site where domestic industries can become competitive before an ASEAN-China FTA comes about.

What needs to be done

AFTA thus retains considerable salience in the evolving regional economic architecture. If member governments commit towards speedy implementation of the remaining component programmes, particularly in services and investment liberalisation, to implement the zero-tariff AFTA and complete the programmes in trade facilitation, that will signal to investors that the regional market remains on the ASEAN agenda and help ASEAN to consolidate itself as a regional market.

To underpin the regional liberalisation process governments must also complete the necessary domestic reforms to place their respective economies on a competitive footing. While many ASEAN governments have engaged in such efforts, for instance Malaysia's push towards banking consolidation, others like Indonesia need to strengthen them. However governments also have to address socio-economic implications of regional liberalisation such as domestic economic and social dislocations. They have to be mindful that the hollowing out of domestic industries and sustained unemployment in segments of the population would be detrimental to ASEAN's growth as a regional market.

ASEAN needs to become a fully viable regional economic space, not just the partial one it is now. At present intra-ASEAN trade accounts for only 20-25 % of total ASEAN trade. AFTA has to develop its capacity as a significant consuming region where economic growth and development raise regional consumption demand for a wider range of goods and services produced within ASEAN.

The regional market is still tied closely to the US economy with its attendant pitfalls of being dependent on one party. ASEAN as a viable regional economic entity will not only reduce economic dependence on any one country or region it will also provide a rich hinterland for all member states. And also reinforce ASEAN's political voice on the global stage.

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