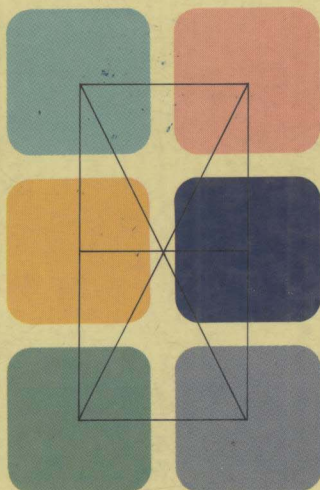


Toward an ASEAN TRADE AREA

By SEIJI NAYA
with the assistance of
PEARL IMADA



INSTITUTE OF STRATEGIC AND INTERNATIONAL STUDIES
(ISIS) MALAYSIA

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International Studies (ISIS) Malaysia in collaboration
with the Resource Systems Institute of the East-
West Center, Hawaii.



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Foreword

THERE is much to be said against summit meetings. They raise expectations that are almost invariably impossible to fulfil. They are often accompanied by pomp out of all proportion to the circumstance. The blare and glare of the mass media are often more conducive to posturing and more productive of rhetoric than of substance and serious decision-making.

But they do often provide a strategic opportunity for forward movement. In the case of ASEAN, the association's Third Summit to be held in Manila in December 1987, has generated intellectual soul-searching and creative turmoil such has not been seen since the mid-1960s.

In March 1987, the Institute of Strategic and International Studies (ISIS) Malaysia organised the First ASEAN Economic Congress under the aegis of the Group of Fourteen on ASEAN Economic Co-operation and Integration. It was attended by some 400 experts, leaders and representatives from ASEAN, the European Community, nations of the European Free Trade Association, Australia, New Zealand, Japan, the United States, Canada and other countries. It was an important occasion for looking back on what been achieved, on what had not, and on what needed to be done. The Group of Fourteen's own report, entitled *ASEAN: The Way Forward*, was released in early July, in time for its presentation at the 19th ASEAN Economic Ministers Meeting in Singapore (9-11 July, 1987).

Elsewhere in Bangkok, Jakarta, Manila, Singapore and Sri Begawan, the intellectual pot has also been boiling.

There has emerged one powerful school of thought: that the *Pax Aseana*, the Peace without an Imperium that has been the greatest achievement of ASEAN, has now to be enriched by bringing economic co-operation to the very core of the ASEAN Process. There has arisen a powerful consensus that it must be brought to the very heart of the Manila Summit — not to diminish in any way the political focus of ASEAN but to supplement it.

This study conducted by Professor Seiji Naya is an important part and an eminent contributor to this movement. ISIS Malaysia is proud to publish it and takes pride in this joint publication with the Resource Systems Institute of the East-West Center, Honolulu, Hawaii.

Dr. Noordin Sopiee
Director-General, ISIS Malaysia

Acknowledgments

The ASEAN Committee on Trade and Tourism (COTT) held a special meeting in Bangkok on 6-8 November 1986, and at that time a request was made to undertake a study to (1) identify possible ways of enhancing intra-ASEAN trade and (2) propose instruments and measures for strengthening intra-ASEAN trade co-operation. The report was prepared and submitted to the ASEAN Secretariat and COTT on 20 March 1987. This study is a slightly revised version of that report. I wish to express my appreciation to the ASEAN Secretariat, to Mr. Ridzwan Dzafir, Chairman of COTT, and to the COTT members of all ASEAN countries for giving me the opportunity to undertake this study. I am grateful to the COTT members of the six individual countries for sharing their views on trade co-operation and for arranging appointments with government officials, leaders in the private sector, and university professors in their countries during my visits to the ASEAN capitals (appendix C). Discussions with them were most helpful and sharpened my thoughts on ASEAN co-operation, enabling me to complete this study on time.

I would like to express my sincere gratitude to UNCTAD and UNDP for their financial support of this study. In particular, I would like to thank UNCTAD officials Messrs. S.A. Abbas and Mikio Tajima for nominating me to do this study and Mr. Erich Supper for providing ASEAN trade data.

Special appreciation also goes to Mr. Chen Jin Fo, Economic Officer, ASEAN Secretariat, who acted as liaison with individual ASEAN countries for my visit and smoothed the way for my mission, and to Mr. David Barker, UNDP, Jakarta, for his administrative support. A summary of the report was presented at the Center for Strategic and International Studies, Jakarta (13 April 1987), Institute of Strategic and International Studies, Kuala Lumpur (16 April 1987), the Philippines Institute for Development Studies, Manila (20 April 1987), and the East-West Center's Board of Governors Meeting, Bangkok (8-14 June 1987). Helpful comments were received at these presentations.

I would also like to thank Dr. Victor Li, President of the East-West Center, who, recognising the importance of this mission, has given me his full support to pursue it. In addition to Pearl Imada, who is cited on the cover page, I would also like to acknowledge Janis Togashi, Lynn Garrett, and Jeni Miyasaki for their research, editorial, and secretarial assistance, respectively. Also, my colleague Burnham Campbell and Mrs. Razon T. Haresco, former chairperson of the Philippine Tariff Commission, made helpful comments on the report. However, the views expressed in it are mine alone, as are any errors that remain.

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I

Introduction

A. ASEAN at a Crossroads

The ASEAN countries, along with the East Asian newly industrialising countries (NICs) of Hong Kong, Korea, and Taiwan, were the most dynamic countries in the world throughout the 1970s. Real economic growth rates of these countries averaged between 6 and nearly 10 percent and exports also grew rapidly. In nominal terms, export growth averaged fantastic rates of 20 to 40 percent.

However, the strong export performance and rapid growth of the ASEAN countries in the 1970s and early 1980s are now being challenged. In the mid-1980s, real economic growth was negligible or even negative in all of the countries except Thailand (table 1). Even in Thailand, however, economic growth was much lower than in previous periods, averaging 4 percent. The poor economic performance corresponded with a sharp decline in the growth of exports, which ranged from negative rates in Brunei, Indonesia, and the Philippines, to a high of 5.2 percent in Thailand in the 1980s (table 2). Despite the poor growth rates in the mid-1980s, the past performance of these countries indicates that they will not be held down for long. Indeed, the situation recently shows signs of improvement, suggesting that the worst is over and the ASEAN countries have started on the path to higher growth. Economic growth rates are still however significantly lower than in the 1970s.

Several changes in the international environment are affecting the growth of these countries. First, the sharp decline in commodity prices in the 1980s meant declining export revenues for the ASEAN countries. The sharp drop in 1986 has dampened growth prospects in oil-exporting Brunei, Indonesia, Malaysia, and Singapore, although prices have since begun to rise. Oil price declines helped the Philippines and Thailand by reducing petroleum import bills, but non-oil commodity prices have also remained weak. The prices of tin, rice, palm oil, and rubber — major export items of most countries in the region — have declined in the

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TABLE 1 *Average Annual Rates of Growth of Real GDP*

Country/group	Year						
	1960-70	1970-80	1980-85	1983	1984	1985	1986 ^a
ASEAN							
Brunei	na	9.0 ^b	-3.7	0.5	0.3	-0.3	na
Indonesia	3.9	7.9	5.3	4.2	5.8	1.9	2.0
Malaysia	6.5	7.8	5.6	6.1	7.9	-1.0	0.5
Philippines	4.8	6.0	0.8	1.1	-4.5	-3.7	0.1
Singapore	9.6 ^c	9.6	6.8	7.9	8.1	-1.8	1.9
Thailand	8.1	6.9	5.4	5.8	6.2	4.0	3.8
NICs							
Hong Kong	10.0	9.0	6.7	6.5	9.3	0.6	8.7
Korea, Republic of	8.8	8.6	5.8	10.9	8.7	5.2	12.8
Taiwan	9.3	9.8	6.3	7.7	9.6	4.3	9.9
South Asia							
Bangladesh	na	5.9 ^d	3.3	3.6	4.2	3.1	5.2
Burma	2.6	4.0	6.0	4.8	6.7	4.3	3.7
India	3.9 ^c	3.5	5.6	7.6	3.6	6.3	5.0
Nepal	1.6	2.1	2.9	-3.0	7.8	3.0	4.2
Pakistan	4.3	4.0	6.9	6.9	4.3	8.2	7.2
Sri Lanka	5.8	5.7	5.1	5.0	4.1	5.0	4.0
Developed Countries							
Japan ^e	11.5	5.4	4.0	3.2	5.1	4.5	2.5
United States ^e	3.8	2.8	2.5	5.0	8.5	2.7	2.5
World	4.9	3.7	2.3	2.6	4.4	3.1	2.9

na = Not available.

^a1986 preliminary estimates except for Japan and the U.S.

^b1975-80.

^c1961-70.

^d1974-80.

^eData refer to growth of real GNP.

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TABLE 2 *Growth of Merchandise Exports^a (percentages)*

Group/Country	Year								
	1960-70	1970-80	1980-86 ^a	1981	1982	1983	1984	1985	1986 ^b
ASEAN									
Brunei	1.0	46.5	-8.6 ^c	-12.9	-5.3	-11.0	-5.5	-7.8	na
Indonesia	2.8	34.8	-6.3	1.6	0.1	-5.1	3.5	-15.1	-20.4
Malaysia	3.6	22.6	1.2	-9.1	2.2	17.2	16.9	-6.3	-10.2
Philippines	5.3	18.6	-3.0	-1.5	-12.1	-1.6	7.9	-12.7	3.8
Singapore	3.2	28.7	2.5	8.2	-0.9	5.0	10.2	-5.2	-1.3
Thailand	5.6	24.8	5.2	8.1	-1.2	-8.3	16.4	-3.9	23.5
NICs									
Hong Kong	13.8	22.9	10.3	10.5	-3.8	4.6	29.0	6.6	17.4
Korea, Republic of	38.1	35.6	12.1	21.4	2.8	11.9	19.6	3.5	14.6
Taiwan	24.6	29.6	12.4	13.9	-1.9	13.6	21.2	1.0	29.5
South Asia									
Bangladesh	na	14.3 ^d	-1.7	4.4	-2.8	-5.9	28.6	7.3	-31.7
Burma	-7.0	15.9	-7.3	1.1	-17.4	-4.1	0.3	-20.1	-1.0
India	4.3	15.5	0.7	-3.4	12.8	-2.2	3.2	-15.3	11.8
Nepal	1.4 ^e	6.7	8.8	75.0	-37.1	6.8	36.2	25.8	-9.3
Pakistan	0.1	20.8 ^f	4.4	10.1	-16.9	28.4	-16.8	7.1	23.5
Sri Lanka	-1.2	12.0	2.3	2.4	-5.2	3.1	38.0	-9.1	-8.9
World	9.3	20.7	-1.0 ^g	-1.7	-7.2	-3.0	5.9	1.2	na
United States	7.7	17.7	-0.3	5.9	-9.2	-5.5	8.7	-2.2	2.0
Japan	16.9	21.0	8.4	16.1	-8.7	6.2	15.5	4.4	19.0
Developing Countries	6.4	25.4	-4.3 ^h	-2.2	-11.6	-7.0	3.7	-4.6	na

na = Not available.

^aCompounded annual growth in current prices.^bEstimate for 1986.^c1980-85.^d1972-80.^e1963-70.**Sources:**Asian Development Bank, *Annual Report*, 1985.International Monetary Fund, *International Financial Statistics*, Yearbook 1986, and Monthly, May 1987.International Monetary Fund, *Direction of Trade Statistics*, Yearbook 1986 and Monthly, May 1987.Republic of China, Council for Economic Planning and Development, *Taiwan Statistical Data Book*, 1985, 1985.United Nations Conference on Trade and Development, *Handbook of International Trade and Development Statistics*, 1987

1980s. Some of the factors behind the lower commodity prices are temporary in nature (e.g., increases in supply as a result of good weather conditions and decreases in demand due to slower growth of world output) but other, longer-term factors have affected both demand and supply of primary commodities. For example, several formerly large importers of food, such as China and India, have achieved virtual self-sufficiency due to improvements in agricultural productivity and in incentives to farmers. At the same time, farm subsidies and artificially high price supports in many developed countries have contributed to surpluses. Moreover, demand for raw materials in production has fallen due to technological improvements, increased miniaturisation, and substitution of man-made materials. These factors, in addition to the shift toward higher technology- and service-oriented industries in developed countries, may indicate a long-run trend toward lower demand for several primary commodities.

Second, advances of protectionism, especially in the major industrial countries, which account for the largest shares of ASEAN trade, have reduced prospects for substantial growth of demand for principal manufactured exports. In the 1970s industrial countries began to limit the rate of growth of labour-intensive imported goods from developing countries, especially clothing and textiles (under the Multifibre Agreement) and footwear. Other labour-intensive exports from developing countries, such as electronics, also began facing import restrictions in the latter half of the decade. Further, the enormous trade deficit and structural adjustment problems of the United States, the largest market for manufactured exports of developing countries, indicate that ASEAN countries will find it more difficult to find ready markets for their manufactures than in the past.

Third, the already high debt-servicing obligations in Indonesia, Malaysia, the Philippines, and Thailand, in conjunction with falling export receipts and declining factor payments from Middle East countries, forced these countries to adopt austerity measures in an effort to correct current account deficits. These nations have limited public borrowing and restricted public spending and imports. The sharp declines in merchandise export growth have been accompanied by even sharper declines in merchandise imports (partly due to low petroleum prices). This has led to improvements in the trade balances of these countries, but it has also contributed to slower economic growth as capital equipment and industrial inputs become less available.

As a consequence, the ASEAN countries find themselves at an important juncture, and they must now face the question of how to increase economic growth without incurring more debt. Rationalisation of domestic policies has begun in all countries, often involving unilateral trade liberalisation. The ASEAN countries have been moving away from import-substitution policies to export-oriented policies in order to

promote industrial efficiency and international competitiveness. The countries with the highest average tariff levels, Indonesia and the Philippines, have recently lowered tariff levels in several sectors, including manufacturing. Indonesia has also decreased non-tariff barriers.

In addition, the ASEAN countries are attempting to enhance growth through further regional co-operation efforts. The challenge faced by ASEAN countries is related to that posed by W. Arthur Lewis in his 1979 Nobel Address; namely, these countries can no longer rely solely on developed countries and must evaluate alternative policies to maintain the trade-related robustness of their economies in the face of perceived slower growth and greater protectionism in the industrial countries.

Regional economic co-operation is difficult and requires a great deal of political will to succeed. The postwar period has seen the formation of many groupings among developing countries, but many of these schemes have since dissolved or are fading out. The widespread distortions in most developing economies, the differing levels of distortions, and the large income differentials between the members make implementation difficult and give rise to concern over the distribution of welfare gains. ASEAN has been among the most successful of regional groupings of developing countries. It has persevered in its efforts to promote regional co-operation.

Increasing regional trade and co-operation will not necessarily increase economic growth. Excessive attempts to divert trade from the lowest-cost producers in the rest of the world can be expensive, and in the long run can lead to stagnant growth. Rather, ASEAN countries must continue to rationalise their domestic policies to increase industrial efficiency and diversify exports. The expansion of intraregional trade should be a step toward overall liberalisation of their economies.

B. The ASEAN Preferential Trading Arrangements

Among the three broad areas of ASEAN economic co-operation (trade, industrialisation, and financial development), progress has been most visible in the area of trade. This emphasis on co-operation in trade is not surprising, as all of the ASEAN countries are trade oriented. One of the major goals of the ASEAN Concord was to increase intraregional trade. The commitment of ASEAN countries to increase intraregional trade through tariff liberalisation was emphasised by the signing of the Agreement on ASEAN Preferential Trading Arrangements (PTA) in 1977. Furthermore, co-operation in trade will facilitate other aspects of ASEAN co-operation, including industrialisation and financial development.

The ASEAN PTA has been successful in terms of coverage, margins of preference, and overall approach. It has provided the framework whereby the Committee on Trade and Tourism (COTT) meets regularly

and negotiates the reduction of duties. Items covered under the ASEAN PTA have increased from an initial exchange of 71 in 1976 to more than 12,000 at present.¹ This has been due in part to a shift from an item-by-item approach to an across-the-board approach in determining concessions. In addition to the large number of concessions, the margin of preference accorded to imports from member-countries has increased. Most important, the ASEAN PTA has established the mechanism for further trade liberalisation. Ten years of experience have provided the foundation for future co-operation.

Nonetheless, the increase in the share of intra-ASEAN trade throughout the 1970s and early 1980s, which is often attributed to the ASEAN PTA, seems to have been more closely related to changes in the prices of a few commodities such as petroleum. Similarly, the recent decline in shares after 1983 corresponds to falling petroleum prices. It appears that the ASEAN PTA has not really created trade; the increase in shares is more apparent than real.

C. Proposals for a New Direction

Under the more difficult conditions in the 1980s, ASEAN must continue to expand regional co-operation. The focus of this paper will be on the most important aspect of ASEAN co-operation, trade. Section II examines the size and pattern of intra-ASEAN trade flows and the characteristics of the ASEAN PTA. Section III analyses some problems confronted by ASEAN countries in their efforts to expand intra-ASEAN trade, concluding that although ASEAN has made substantial progress in trade co-operation — especially in terms of setting up a framework for future negotiations — the present ASEAN PTA may have outlived its usefulness. In Section IV the pros and cons of some traditional forms of trading arrangements are examined, including free trade areas and customs unions. Conceptual issues of the different trading arrangements and their applicability to ASEAN are discussed. Special attention is given to the thorny problem of the domestic content requirement and the implications of the differing levels of development in the region. For various reasons, both political and economic, we find that these trading arrangements are not appropriate or are premature for ASEAN under present conditions. Instead, in Section V an arrangement is suggested that combines several elements of the conventional forms of economic co-operation discussed in Section IV and that goes beyond the present ASEAN PTA. This arrangement may be called the ASEAN Trade Area. The final section summarises recommendations toward the establishment of this ASEAN Trade Area. It

¹Note that the number of concessions given is nearly twice this figure. Some items have been accorded deeper concessions in successive negotiations.