

Chirathivat, Suthiphand; Srisangnam, Piti

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## The 2030 architecture of Association of Southeast Asian Nations Free Trade Agreements

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## **ADB Working Paper Series**

### **The 2030 Architecture of Association of Southeast Asian Nations Free Trade Agreements**

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Suthiphand Chirathivat  
and Piti Srisangnam

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Suthiphand Chirathivat and Piti Srisangnam are executive director and deputy director of academic affairs, respectively, at the ASEAN Studies Center of Chulalongkorn University, Thailand.

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Please contact the authors for information about this paper.

Email: [Suthipand.C@chula.ac.th](mailto:Suthipand.C@chula.ac.th); [piti31@gmail.com](mailto:piti31@gmail.com)

Asian Development Bank Institute  
Kasumigaseki Building 8F  
3-2-5 Kasumigaseki, Chiyoda-ku  
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500  
Fax: +81-3-3593-5571  
URL: [www.adbi.org](http://www.adbi.org)  
E-mail: [info@adbi.org](mailto:info@adbi.org)

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**Abstract**

This paper investigates and analyzes the present status, potential, and prospects of Association of Southeast Asian Nations (ASEAN) free trade agreements (FTAs). It begins with a review of the historical evolution of ASEAN FTAs, which captures the achievements of the ASEAN Free Trade Agreement (AFTA) and the efforts meant to lead to a further step of deeper integration, i.e., the realization of the ASEAN Economic Community (AEC) by 2015. The paper then offers a view on how the grouping adopted an extension of ASEAN FTAs beyond the AEC—a widening integration process that includes ASEAN+1 FTAs, bilateral trading arrangements, and region-wide economic integration. These parallel developments present major challenges to ASEAN, particularly the move towards the AEC by 2015 and the attempts to broaden FTAs in East Asia. Ultimately, it is desirable for ASEAN to draw a clear picture of how the architecture of ASEAN FTAs in 2030 can be given shape.

**JEL Classification:** F13, F14, F15

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# 1. INTRODUCTION

The economic world in 2030 will be unrecognizable from what it is today as emerging countries, including the Association of Southeast Asian Nations (ASEAN) region as a whole, grow faster than advanced economies as a result of the global financial crisis. Looking from this perspective, ASEAN has come a long way in terms of developing its own economies and creating synergy on working regionally in the so-called “ASEAN way” in order to move forward.

The grouping was fairly successful in realizing implementation of the ASEAN Free Trade Area (AFTA), which started in 1992. With the rapid development of bilateral free trade agreements (FTAs), in particular the ASEAN+1<sup>1</sup> process in the years following the Asian financial crisis of 1997–1998, there has also been a proliferation of multilayered FTAs, creating the so-called “Asian noodle bowl effect”.<sup>2</sup> ASEAN then realized the necessity to launch the ASEAN Economic Community (AEC) blueprint in 2009, with its own version of deepening regional integration, aiming to transforming the region into a single market and production base. The emergence of ASEAN as the hub of Asia’s FTAs has only occurred since 2000 (Kawai and Wignaraja 2011).

The development of ASEAN FTAs has to be viewed within the new dynamics of the changing global and regional environment. First, burgeoning trade and investment links between ASEAN and many trading partners in Asia and beyond are creating new markets and production networks that ASEAN has to take into consideration more than in the past. The way in which ASEAN production fragmentation and agglomeration work, in terms of both efficiency and competitiveness, seems to correspond with broader regional integration, with less protection and more liberalization. Second, differences among ASEAN countries and FTA partners remain, even among ASEAN’s own member states, in areas such as population, levels of development, openness to trade and investment, and institutional arrangements. ASEAN has no choice but be committed to making steady progress in FTA policy formulation and to apply a pragmatic approach wherever possible (Chirathivat 2008, Chia 2010). Third, the grouping, fortunately, feels the need to work with FTA partners of all sorts, starting with some of the most important issues that might hinder progress, whether this concerns trade in goods, services, or investment. For instance, issues of concern include FTA preference utilization, the “noodle bowl” complication of multilayered agreements, and diversion from the multilateral trading system (Kawai and Wignaraja 2011).

In this respect, the emerging architecture of ASEAN FTAs should correspond to the future development of the region, of which the AEC is the current cornerstone, and the way in which ASEAN aspires to work on the expanded version of regional economic integration in view of the limitations of bilateral agreements and ASEAN+1 FTAs. A more definite direction for ASEAN seems necessary to accelerate the consolidation of all existing FTAs into concrete modalities, actions, and the implementation of such initiatives to broaden FTAs in Asia. ASEAN’s regional integration and centrality will only be successful if deepened integration of the AEC functions properly and linkages with regional and global partners are broadened through a proper policy framework of region-wide trading arrangements. ASEAN has to lead the way and show what can be done more effectively in a new world of interlocking FTAs.

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<sup>1</sup> ASEAN+1 refers to an ASEAN member plus a dialogue partner.

<sup>2</sup> The Asian noodle bowl effect, or the “Asian style spaghetti bowl effect”, is a phenomenon of international economic policy that refers to the complication which arises from the application of domestic rules of origin in the signing of free-trade agreements across nations. The effect leads to discriminatory trade policy because the same commodity is subjected to different tariffs and tariff reduction trajectories for the purpose of domestic preferences. With the increase in FTA’s throughout the international economy, the phenomenon has led to paradoxical, and often contradictory, outcomes amongst bilateral and multilateral trade partners.

## **2. HISTORICAL EVOLUTION OF ASSOCIATION OF SOUTHEAST ASIAN NATIONS FREE TRADE AGREEMENTS**

Economic regionalism in Southeast Asia was not on the map when ASEAN was formed in 1967. The Bangkok Declaration<sup>3</sup> only mentioned that economic progress was necessary in order to move these countries forward. From a timid beginning of five original countries to 10 countries within four decades or so, ASEAN has progressively become more credible by the standards of any other regional arrangements in the developing world.

ASEAN is in a unique position. Its turbulent past, primarily because of geopolitical and security factors, made economic cooperation initially less important, although it has been mentioned ever since the Bali Summit in 1976. That was the year after Cambodia, the Lao People's Democratic Republic (Lao PDR), and Viet Nam were ruled by communist regimes. ASEAN had to wait until the end of the Cold War to find new impetus for its own economic cooperation. The advent of the AFTA in 1992 was a natural response to safeguard the region. For some it appeared inevitable in light of the changing regional and global environment at the time. With the conclusion of the General Agreement on Tariffs and Trade (GATT) Uruguay Round at the beginning of the 1990s, global trade liberalization became serious, with implementation of several regional trade liberalization initiatives, in particular the European Single Market, the North American Free Trade Area (NAFTA), and the Asia-Pacific Economic Cooperation (APEC). Indeed, the term "regional integration" was never mentioned in ASEAN official documents until December 1998, by following the Hanoi Plan of Action (Ariff 2001).

### **2.1 Achievements of the Association of Southeast Asian Nations Free Trade Area**

The milestones of ASEAN achievements during the AFTA period of 1992 to the realization of the 2015 ASEAN Economic Community are presented in Table 1.

According to the Common Effective Preferential Tariff (CEPT) scheme, from 1993 to 2010 the total number of tariff lines from all ASEAN inclusion lists with zero tariff rates would increase from 15,149 (32% of total tariff lines [calculated by the authors from data in table 2]) to 85,916 (98% of total tariff lines [calculated by the authors from data in table 2]). In terms of AFTA trading preferential usage, the utilization ratios of the AFTA have gradually increased (Table 3), e.g., the utilization ratios for Thailand's exports to ASEAN increased from 4.0% in 1998 to 20.2% in 2006. The same ratios for Malaysia increased from 1.2% to 9.2% over the same period (Hiratsuka 2008).

This preferential tariff scheme does not only benefit ASEAN member states but also ASEAN's major trading partners, especially Japan. According to the survey of Japanese-affiliated firms in ASEAN, India, and Oceania conducted by the Economic Research Institute for ASEAN and East Asia (ERIA) in 2009, 31% of Japanese importers from ASEAN and 33% of Japanese exporters to ASEAN enjoyed AFTA tariff preferences (Hayakawa et al. 2009).

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<sup>3</sup> The Bangkok Declaration or ASEAN Declaration is the founding document of Association ASEAN. It was signed in Bangkok on 8 August 1967 by the five ASEAN founding members—Indonesia, Singapore, the Philippines, Malaysia, and Thailand.

**Table 1: Milestones of Association of Southeast Asian Nations Economic Cooperation Achievements**

1992	The ASEAN Free Trade Agreement (AFTA) and a Common Effective Preferential Tariff (CEPT) scheme signed in Singapore
1994	ASEAN establishes the ASEAN Regional Forum (ARF)
1995	Signing of ASEAN Framework Agreement on Services (AFAS)
1997	First ASEAN– People's Republic of China (PRC) Summit
	First ASEAN+3 Meeting
	Chiang Mai Initiative (CMI) set up
	ASEAN adopts ASEAN Vision 2020
2003	Bali Concord II: ASEAN Community comprises three pillars: the ASEAN Political-Security Community, ASEAN Economic Community, and ASEAN Socio-Cultural Community
	“ASEAN Minus X” formula was introduced in the Protocol to Amend the ASEAN Framework Agreement on Services
2005	Mutual Recognition Arrangement (MRA): Engineering Services
2006	First ASEAN+6 Meeting
	MRA: Architectural Services, Nursing Services; Framework Arrangement for the Mutual Recognition: Surveying Qualifications
2007	ASEAN Charter and ASEAN Economic Community (AEC) Blueprint signed
2008	MRA: Medical Practitioners, Dental Practitioners; MRA Framework: Accountancy Services
2010	All tariffs for products in the CEPT Inclusion Lists of ASEAN–6 eliminated for intra-ASEAN trade
	ASEAN Trade In Goods Agreement (ATIGA) implemented and the cancelation of NTMs by Brunei Darussalam, Indonesia, Malaysia, Singapore, and Thailand
	Target: Elimination of all barriers to trade and allow 70% ASEAN equity ownership in four priority service sectors (air travel, e-ASEAN, health care, tourism)
2013	Target: Elimination of all barriers to trade and allow 70% ASEAN equity ownership in logistics services
2015	Target: ASEAN Economic Community
	Target: Elimination of tariffs by Cambodia, the Lao People's Democratic Republic, Myanmar, and Viet Nam
	Target: Elimination of all barriers to trade and allow 70% ASEAN equity ownership in all service sectors

AEC = ASEAN Economic Community; AFAS = ASEAN Framework Agreement on Services; AFTA = ASEAN Free Trade Agreement; ARF = ASEAN Regional Forum; ATIGA = ASEAN Trade In Goods Agreement; CEPT = Common Effective Preferential Tariff; CMI = Chiang Mai Initiative; MRA = Mutual Recognition Arrangement; PRC = People's Republic of China.

Source: Authors' compilation.



**Table 2: Number of Tariff Lines in Common Effective Preferential Tariff Scheme 1993 and 2010 Packages**

ASEAN member country	Distribution of Product Groups According to AFTA CEPT 1993						Distribution of Product Groups According to ATIGA AEC 2015				
	Fast Track	Normal Track	Temporarily Excluded	General Exception	Unprocessed Agricultural Products	Total	Eliminated Tariff (0%)	Sensitive List (0–5%)	Highly Sensitive List	General Exclusion List	Total
Brunei Dar.	2,420	3,659	208	201	56	<b>6,544</b>	8,207	16		77	<b>8,300</b>
Cambodia							10,536	55		98	<b>10,689</b>
Indonesia	2,816	4,539	1,654	50	324	<b>9,383</b>	8,625		16	96	<b>8,737</b>
Lao PDR							10,566	26		98	<b>10,690</b>
Malaysia	3,166	5,611	627	98-product	541	<b>10,023</b>	12,136	83	12	96	<b>12,327</b>
Myanmar							8,240	11		49	<b>8,300</b>
Philippines	1,033	3,418	714	28	398	<b>5,591</b>	8,854	80	19	27	<b>8,980</b>
Singapore	2,205	3,517		120		<b>5,842</b>					
Thailand	3,509	5,254	118 (10-digit HS Code)	26-product	415	<b>9,322</b>	8,287	13			<b>8,300</b>
Viet Nam							10,465	58		166	<b>10,689</b>

Brunei Dar. = Brunei Darussalam; AEC = ASEAN Economic Community; AFTA = ASEAN Free Trade Agreement; ATIGA = ASEAN Trade In Goods Agreement; CEPT = Common Effective Preferential Tariff.

Source: ASEAN Secretariat (1993, 2010).

**Table 3: Asian Free Trade Agreement Utilization Ratios in Thailand and Malaysia, 1998–2006**

<b>Country/Region</b>		<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Thailand	Brunei Darussalam	0.4	1.3	0.7	1.4	2.3	2.1	3.2	3.9	8.2
	Cambodia	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
	Indonesia	6.1	12.6	20.8	24.9	23.8	32.1	41.5	45.9	50.6
	Lao PDR	0.0	0.0	0.0	0.0	0.0	0.9	3.1	2.8	2.3
	Malaysia	11.9	14	12.7	15.5	20.4	20.7	22.1	22.4	20.5
	Myanmar	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.4
	Philippines	13.1	16.1	14.5	10.2	24.3	31.6	40.4	41.8	37.6
	Singapore	0.2	0.1	0.2	0.4	0.9	1.8	2.7	2.7	2.5
	Viet Nam	1.1	9.0	6.3	8.2	13.8	31.2	33.8	41.5	39.9
	<b>Total</b>	<b>4.0</b>	<b>5.7</b>	<b>6.4</b>	<b>8.6</b>	<b>10.8</b>	<b>15.5</b>	<b>19.3</b>	<b>21.5</b>	<b>20.2</b>
Malaysia	Brunei Darussalam	0.0	0.0	0.0	0.8	0.9	0.5	0.3	0.8	2.1
	Cambodia	0.0	0.0	0.4	0.0	0.0	0.0	0.3	0.5	0.5
	Indonesia	3.5	2.6	2.5	6.1	6.8	8	12.1	19.6	12.4
	Lao PDR	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.8
	Myanmar	0.0	0.0	0.0	0.1	0.0	0.9	2.2	1.7	0.3
	Philippines	6.8	10.3	8.7	13.1	12.4	17.1	19.4	24.2	25.0
	Singapore	0.1	0.1	0.1	0.2	0.3	0.8	1.0	0.9	2.9
	Thailand	3.9	8.0	6.8	10.8	11.3	13.0	16	16.2	14.9
	Viet Nam	0.2	3.0	3.5	8.1	11.3	28.9	32.6	31.7	46.7
	<b>Total</b>	<b>1.2</b>	<b>2.0</b>	<b>1.8</b>	<b>3.2</b>	<b>3.6</b>	<b>5.3</b>	<b>7.2</b>	<b>7.9</b>	<b>9.2</b>

Lao PDR = Lao People's Democratic Republic.

Source: Adapted from Hiratsuka (2008).

ASEAN member states mandated creation of AFTA in during 1993–2008). According to the original schedule, ASEAN would phase out all tariff measures by 2008. However, this target was delayed until realization of the AFTA on 1 January 2010 when all tariffs for products in the CEPT inclusion lists of ASEAN-6<sup>4</sup> were eliminated for intra-ASEAN trade. All tariff rates applying to products under the sensitive lists would decrease to 0%–5%. Cambodia, the Lao People’s Democratic Republic (Lao PDR), Myanmar, and Viet Nam (the so-called CLMV countries) would also fully ratify the tariff reduction schedule to phase out all tariffs by 2015, with a flexible extension to 2018.

During the AFTA period (1992–2010), ASEAN had achieved much in removing or reducing tariff measures. Nevertheless, AFTA still has several major challenges to realizing deeper economic integration, such as the existing nontariff measures (NTMs), sometimes considered as nontariff barriers (NTBs); the unfavorable complex rules of origins; and problems with the implementation of trade facilitation measures.

To expand the scope of economic integration beyond trade in goods, ASEAN officially set the target to expand the scope of AFTA to include the free flow of trade in services by implementation of the ASEAN Framework Agreement on Services (AFAS). AFAS is aimed at eliminating restrictions on trade mode 3 (Commercial Presence) and mode 4 (Movement of Natural Persons) of service supplies among ASEAN countries with the GATS-Plus<sup>5</sup> principle. To this end, the “ASEAN minus X formula” method was introduced to ASEAN with the objective of accelerating market access improvements among members. Under this system, a pair or group of ASEAN member states which were ready to open any service sector could proceed without any concession to the member states that were not ready. Currently, the eighth package of commitments under AFAS has been applied. Improved market access and the realization of equal national treatment for services suppliers will gradually be realized among the member countries.

## **2.2 Realization of the Association of Southeast Asian Nations Economic Community**

After recovering from the Asian financial crisis of 1997–1998, ASEAN started to feel the need to move beyond the scope of AFTA to attract more capital inflows, especially from East Asia. Deepening ASEAN integration by tightening the scope of economic integration among the 10 member states became a necessity for moving forward. From that point onwards, the ASEAN Economic Community blueprint was proposed and finally signed, with the aim of creating a single market and production base by promoting the free flows of goods, services, capital, and skilled labor. The current status of the AEC and the goal of AEC 2015 in each element is presented in Table 4.

Trade in goods is the most obvious area people think of when it comes to trade liberalization. To promote a free flow of goods in order to position itself as a production base for both ASEAN and ASEAN dialogue partners and investors, ASEAN switched from a collection of agreements related to trade in goods to a comprehensive agreement—the ASEAN Trade in Goods Agreement (ATIGA). ATIGA covers more than tariff reduction as it also includes elimination of NTBs, procedures,

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<sup>4</sup> ASEAN-6 is the original members of ASEAN before the implementation of AFTA in 1992—Thailand, Malaysia, Singapore, Indonesia, the Philippines, and Brunei Darussalam.

<sup>5</sup> GATS-Plus refers to services that are additional to the service sectors liberalization requirements of the World Trade Organization multilateral General Agreement on Trade in Services (GATS).

and documentary requirements and best practices in trade facilitation applied by each member state.

**Table 4: Current Status of Association of Southeast Asian Nations Economic Community and the Goal of Association of Southeast Asian Nations Economic Community 2015**

Issue	Status (as of 2010)	AEC 2015
Overview of AEC		Achieve the objectives of the ASEAN Economic Community Blueprint and announce ASEAN post-2015 vision
<b>I. Single Market and Production Base</b>		
<b>Free flow of Goods</b>		
Tariff elimination	All tariffs for products in the CEPT inclusion lists of ASEAN-6 eliminated for intra-ASEAN trade. Fully ratify tariff reduction schedule for CLMV	All tariffs for products in the CEPT inclusion lists, sensitive lists and highly sensitive lists are eliminated  Sensitive lists of ASEAN-10 eliminated for intra-ASEAN trade with flexibility for some sensitive products by 2018 for CLMV
Nontariff measures (NTMs) and nontariff barriers (NTBs) elimination	Verification and cross-verification of NTBs among ASEAN member progressing  Target set to remove all NTBs by 2010 for ASEAN-5, by 2012 for the Philippines, and by 2015 with flexibility to 2018 for CLMV	Significant progress in eliminating NTMs and NTBs among ASEAN members
Rules of origin	ASEAN Working Group on Rules of Origin concluded	Rules of origin and self-certificate system made more user-friendly and accessible with a low transaction cost
Trade facilitation	ASEAN Trade Facilitation Framework and Work Program adopted  ASEAN working group on tariff nomenclature and on customs procedures concluded	ASEAN single windows systems enabled and accessible. Issues such as customs, trade procedures, standards and conformance, sanitary, and phytosanitary solved
<b>Free flow of Services</b> (Mode 3: Commercial presence)	Elimination of all barriers to trade and 70% ASEAN-equity participation allowed in the following priority service sectors: air transport, e-ASEAN, health care, tourism by 2010, and logistics by 2013	All barrier to trade eliminated and 70% ASEAN equity participation allowed in all service sectors
<b>Free flow of Skilled Labor</b> (Mode 4: Presence of natural persons)	Mutual recognition arrangement (MRA): engineering services, architectural services, nursing services, medical practitioners, dental practitioners; framework arrangement for mutual recognition: surveying qualifications; MRA framework: accountancy services signed. ASEAN Agreement on Movement of Natural Persons (MNP) formulating	

Issue	Status (as of 2010)	AEC 2015
<b>Free flow of Investment</b>	<p>ASEAN adopted modality for elimination of investment restrictions and impediments under the ASEAN Comprehensive Investment Agreement (ACIA, built on the existing ASEAN Investment Area (AIA) Agreement and ASEAN Investment Guarantee Agreement [IGA])</p> <p>ASEAN members complete assessment and identification of rules for freer flow of Foreign Direct Investment and portfolio investment</p>	ASEAN production network with more cost-competitiveness and greater economies of scale
<b>Freer flow of Capital</b>	<p>Road map for monetary and financial Integration of ASEAN developing</p> <p>ASEAN Exchanges initiative launched linking the region's seven stock exchanges</p>	Fully functional ASEAN bond market (debt market) and ASEAN Exchanges (capital market) with removal or relaxation of restrictions to facilitate flows of payments and transfers for current account transactions and to support foreign direct investment
<b>II. Competitive Economic Region</b>		
Competitive policy	<p>ASEAN Regional Guidelines on Competition Policy and Handbook on Competition Policy and Law in ASEAN for Business launched</p> <p>ASEAN expert group on competition (AMGC) developing a capacity building program for ASEAN members</p>	Network of authorities or agencies responsible for competition policy established to serve as a forum for discussing and coordinating competition policies
Consumer protection	Road-mapping Capacity Building Needs in Consumer Protection in ASEAN implemented by ASEAN Committee on Consumer Protection (ACCP)	Network of consumer protection agencies established to facilitate information sharing and exchange
Intellectual property rights	Common Regional IP Profiles, ASEAN Patent Search and Examination Cooperation (ASPEC), and ASEAN IP Direct organized by the ASEAN Working Group on IP Cooperation	Consultations and information exchanges among national enforcement agencies in IPR protection; regional cooperation on traditional knowledge, genetic resources, and cultural traditional expressions promoted
Infrastructure development and ratification of transport agreements	<p>Brunei Action Plan and ASEAN Multilateral Agreement on the Full Liberalization of Passenger Air Services developed</p> <p>Master Plan on ASEAN Connectivity implemented</p>	Fully functional ASEAN transportation networks and facilities

Issue	Status (as of 2010)	AEC 2015
III. Equitable Economic Development		
Initiative for ASEAN Integration (Work Plan 2)	The IAI currently covers the following priority areas: infrastructure, human resource development, information and communication technology (ICT), capacity building for regional economic integration, energy, investment climate, tourism, poverty reduction, and improvement in the quality of life	ASEAN-10 as an equal partner in development of regional production and distribution networks  Subregional arrangements such as the GMS, IMT-GT, and BIMP-EAGA as focal points for ASEAN economic development
Studies and development of ASEAN SMEs	Strategic Plan of Action for ASEAN SME Development (2010–2015) adopted to accomplish SME flagship projects to facilitate SMEs' access to market, services, and know-how	SME development fund, integrated national SME service center, multimedia self-reliant system toolkit package, and SME development policies for CLMV established and implemented
IV. Integration with the Global Economy		
People's Republic of China	ASEAN–PRC FTA (ACFTA) ratified	Comprehensive cooperation (including goods, services, investments, and movement of labor) between ASEAN and major dialogue partners
Japan	ASEAN–Japan Comprehensive Economic Partnership (AJCEP) ratified	
Republic of Korea	ASEAN–Korea FTA (AKFTA) ratified	
Australia	ASEAN–Australia–New Zealand FTA (AANZFTA) ratified	
New Zealand		
India	ASEAN–India FTA (AIFTA) only Trade in Goods (TIG) agreement was ratified	
ASEAN+3		
ASEAN+6		

AANZFTA = ASEAN–Australia–New Zealand Free Trade Agreement; ACCP = ASEAN Committee on Consumer Protection (ACCP); ACFTA = ASEAN–PRC Free Trade Agreement; ACIA = ASEAN Comprehensive Investment Agreement; AIA = ASEAN Investment Area; AIFTA = ASEAN–India Free Trade Agreement; AJCEP = ASEAN–Japan Comprehensive Economic Partnership; AKFTA = ASEAN–Korea Free Trade Agreement; AMGC = ASEAN expert group on competition; ASPEC = ASEAN Patent Search and Examination Cooperation; BIMP-EAGA = Brunei Darussalam–Indonesia–Malaysia–Philippines East ASEAN Growth Area; CEPT = Common Effective Preferential Tariff; CLMV = Cambodia, Lao PDR, Myanmar, Viet Nam; GMS = Greater Mekong Sub-region; ICT = information and communication technology; IGA = ASEAN Investment Guarantee Agreement; IMT-GT = Indonesia Malaysia Thailand Growth Triangle; MNP = Movement of Natural Persons; MRA = Mutual recognition arrangement; NTBs = Nontariff barriers; NTMs = Nontariff measures; SMEs = Small and Medium Enterprises; TIG = Trade in Goods.

Source: Authors' compilation.

Nevertheless, on the path to a single market, a common external tariff was not mentioned in ATIGA. The possibilities of ASEAN moving towards an ASEAN customs union is probably very low, since the creation of such a union could well have negative consequences for the countries involved. The share of intra-ASEAN trade is still not great (Table 5). Consequently, a restrictive common external tariff would lead to much trade diversion and little trade creation (Cuyvers and Pupphavesa 1996).

**Table 5: Intra-Association of Southeast Asian Nations Trade to Total Trade Ratios, 1999–2010**

Year	Brunei Dar.	Indonesia	Malaysia	Philippines	Singapore	Thailand	Cambodia	Lao PDR	Myanmar	Viet Nam
1999	35.07	17.97	23.65	14.26	24.80	17.32	34.99	71.84	38.55	24.94
2000	33.88	18.16	25.40	15.60	26.04	18.08	24.75	65.04	35.83	23.47
2001	29.62	17.15	24.05	15.50	25.99	17.81	40.74	63.96	38.63	21.52
2002	30.20	18.88	24.61	15.94	26.66	18.32	21.69	62.37	40.19	19.76
2003	26.34	19.71	24.63	17.60	30.82	18.68	20.35	59.20	40.53	19.60
2004	28.55	20.74	24.67	18.15	29.58	19.45	18.49	58.66	46.31	20.21
2005	34.01	22.92	25.54	18.07	28.87	20.08	16.78	65.22	50.99	21.77
2006	33.10	23.13	25.39	18.61	28.61	19.58	19.32	69.25	49.90	22.63
2007	36.07	24.44	25.14	19.72	28.57	19.68	35.32	66.52	46.48	21.57
2008	33.25	25.59	25.15	20.42	27.81	19.84	22.91	67.00	53.69	20.85
2009	27.80	24.52	25.49	20.70	27.24	19.97	23.64	61.01	46.34	17.61
2010	24.48	24.62	29.99	23.26	27.27	19.75	22.77	61.99	44.08	17.16

Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.

Source: Authors' calculations.

The share of intra-ASEAN trade over total international trade of the ASEAN+6 countries increased from 22.2% in 1999 to 24.9% in 2010. This is the opposite of the CMLV countries, where it has declined from 42.6% in 1999 to 36.5% in 2010. Despite this, extraregional trade is significantly more important than intra-ASEAN trade. Apart from the low intra-ASEAN trade, the extra-ASEAN effective tariff schemes range from 0% imposed by Singapore to 14.2% in Cambodia (World Trade Organization [WTO] Secretariat 2010) and the development gap both among ASEAN-6 countries and between them and the CLMV countries also act as an obstacle to realization of the ASEAN customs union.

Without any attempt to negotiate the common external tariff, the system of rules of origin becomes more important in avoiding trade diversion as well as moving ASEAN toward deeper economic integration. As mentioned by Rashid et al., "ASEAN is fully cognizant that the elimination of tariffs in ASEAN will not be sufficient to achieve a single market and production base. Rules of origin regimes that enable trade are also needed" (Rashid et al. 2009: 28). To simplify the rules of origin among ASEAN members, especially for some products where it is considered very difficult to meet the 40% ASEAN Regional Value Content rule (such as iron and steel products and textile products), the change in tariff heading (4-digit HS Code) method has been adopted. However, in-depth interviews with more than 30 iron and steel producers, traders, and end users in Thailand have indicated that most of them still claimed that the problem comes not only from the rules of origin themselves but also from the more difficult parts such as the system for obtaining a certificate of origin (Yingsittisawat et al. 2011). It is not only the local ASEAN firms which face a delay because of these procedures. A survey by the Japan External Trade Organization (JETRO) in 2004 and 2011 found there was also a wide variety in the number of days required for Japanese-affiliated firms for acquisition—40.2% of 594 Japanese firms using FTAs and/or economic partnership agreements in Asia and Oceania found it takes 2–14 working days to process documents for obtaining a certificate of origin

(Wakamatsu 2004, JETRO 2011). The self-certificate scheme for the declaration of origin (still in the development process) is also needed to help realize a single market and production among the ASEAN member states.

With ATIGA, ASEAN set the time frame to eliminate both tariff barriers (especially for products on the sensitive and highly sensitive list) and NTBs by 2015. If this could be realized, the expected benefits should be significant, according to an estimate using a computable general equilibrium model (Global Trade Analysis Project [GTAP] model) to measure the effects of the AEC, as presented in the paper by Rashid et. al in 2009. ASEAN as a whole can expect to obtain gains in social welfare (in term of equivalent variations) of US\$10.1 billion from AFTA, US\$38.0 billion from ASEAN+1 and US\$69.4 billion from full implementation of the AEC. Indonesia, Singapore, and Thailand are expected to gain the most. The results of another Global Trade Analysis Project simulation model by Wongboonsin and her team in 2011 also confirmed that ASEAN as a whole would gain under the framework of the AEC free trade in goods (Wongboonsin, Srisangnam, and Sermcheep 2011). According to this document, Singapore would gain the most in terms of social welfare (US\$797.9 million), followed by Thailand (US\$666.9 million), and Indonesia (US\$276.5 million).

For trade in services, the AEC gave a very broad framework and time frame in which to remove all restriction on trade in services among ASEAN member states by 2010 for four priority integration sectors (air transport, e-ASEAN, health care, and tourism), by 2013 for logistics services, and by 2015 for all other services sectors. Not less than 70% of ASEAN equity participation (where ASEAN investors are allowed to own up to 70% or more shares in services companies) will be implemented by 2015 for all sectors. However, there is concern that the lack of official rules of origin to identify the nationality of ASEAN investors who plan to apply for these preferences may delay this process.

For the movement of capital, ASEAN adopted the elimination of investment restrictions and impediments under the ASEAN Comprehensive Investment Agreement (ACIA). In 2010, ASEAN members completed the assessment and identification of rules for freer flow of foreign direct investment and portfolio investment. The next challenge for ASEAN is to ensure that ASEAN investors will be granted treatment equal to locals at the pre-establishment and post-establishment stage. The computable general equilibrium approach to estimating the effect of the AEC free flow of investment was presented in the paper by Ariyasajakorn et al. in 2009. ASEAN as a whole can expect to gain higher returns to capital. For instance, Viet Nam (4.71%), Thailand (3.48%), and Malaysia (2.88%) are expected to be the top three countries for higher returns to capital.

The AEC also agreed to ease the free flow of professional employees, but only seven mutual recognition agreements (MRAs) were finally signed (for engineering services, architectural services, nursing services, medical practitioners, dental practitioners, surveying qualifications, and accountancy services). The ASEAN Agreement on Movement of Natural Persons is being formulated but is still some way from being finalized. To illustrate the issue, even though border controls have been eliminated for the seven professions, beyond-the-border issues as well as the issue of harmonizing domestic rules and regulations in each ASEAN member country are still major impediments to trade liberalization and granting of national treatment.



### **3. EXTENSION OF ASSOCIATION OF SOUTHEAST ASIAN NATIONS FREE TRADE AGREEMENTS BEYOND ASSOCIATION OF SOUTHEAST ASIAN NATIONS ECONOMIC COMMUNITY**

#### **3.1 Association of Southeast Asian Nations+1 Free Trade Agreements**

Each ASEAN member integrates itself into the global economy via a dual-track system, e.g., ASEAN+1 and bilateral trading agreements. For the first track of regional economic integration, the AEC is an important strategy in positioning Southeast Asia as a gateway to the world's largest internal markets such as the PRC and India. At the same time, it also attracts large regional firms from both within and outside of ASEAN—especially Japan, the Republic of Korea, and Australia—to invest more in this region. So far ASEAN has acted as an integration hub for FTAs in East Asia. The following agreements have all been ratified since 1 January 2010: the ASEAN-PRC FTA, the ASEAN-Japan Comprehensive Economic Partnership, the ASEAN-Korea FTA, and the ASEAN-Australia–New Zealand FTA. All of these agreements cover more than liberalization of trade in goods, also covering trade in services, investment, and other forms of economic cooperation. A trade-in-goods agreement only was ratified under the ASEAN-India FTA. The elements of each ASEAN+1 FTA are in Table 6.

**Table 6: Elements of Association of Southeast Asian Nations (ASEAN)+1 Free Trade Agreements**

Item		ASEAN–Australia–New Zealand Free Trade Area (AANFTA)	ASEAN–PRC Free Trade Area (ACFTA)	ASEAN–India Free Trade Area (AIFTA)	ASEAN–Japan Comprehensive Economic Partnership (AJCEP)	ASEAN–Korea Free Trade Area (AKFTA)
Agreement signed, implemented, realization		2009, 2010, 2015–2018	2002, 2004, 1 Jan. 2010	TIG 2009, 2010, 2016	2008, 2008, 10 years from EIF	2006, 2007, 2007
Approach to negotiations		Comprehensive single undertaking	Sequential	Sequential	Single undertaking	Sequential
Combined gross domestic product		US\$2.61 trillion (2009)	US\$6.41 trillion (2009)	US\$2.74 trillion (2009)	US\$6.4 trillion (2008)	
Trade value with ASEAN		US\$49.2 billion (2009)	US\$178.2 billion (2009)	US\$39.1 billion (2009)	US\$157.8 billion (2009)	US\$74.7 billion (2009)
Total population		616 million	World's biggest FTA in term of consumer market size (1.92 billion)	1.8 billion	711 million	
Trade in goods	Normal track	Eliminate tariffs on at least 90% of all tariff lines within specific time frames	Tariff elimination by 2010 for ASEAN-6 and PRC (flexibilities to 2012 for 150 tariff lines )	Tariff elimination by 2016 for India and ASEAN–6 (except Philippines); tariff elimination by 2019 for Philippines and longer time frame for CLMV	10-year Entry into Force (EIF) for 92% of Japanese tariff lines, 90% of ASEAN–6, and Vietnamese tariff lines (2018)	In 2007, Republic of Korea and ASEAN–6 (except Thailand) have eliminated tariffs on 90% of products in the normal track. For Viet Nam, at least 50% of tariff lines under the normal track will be subject to a 0–5% tariff rate not later than 1 January 2013, and no later than 1 January 2015 for CLM. The reduced tariffs rates of 0–5% will reach 90% of tariff lines by 2016 for Viet Nam and 2018 for CLM. The zero tariff for all normal track products will be implemented by 2017 for Viet Nam and 2020 for CLM. For Thailand, which acceded to the AK-TIG in 2007, the tariffs for normal track products will be eliminated by 2016–2017
			Tariff Elimination by 2015 for CLMV (flexibilities to 2018 for 250 tariff lines )		13-year EIF for 90% CLM Tariff Lines (2021)	
	Sensitive track		SL: First tariff reduction to 20% followed by 0%–5%	Tariff reduced to 5% by 2016 for India and ASEAN–6 (except Philippines), by 2019 for Philippines, and by 2021 for CLMV	Various modalities with bilateral tariff reduction negotiation	
			HSL: Tariff rate not more than 50%	Tariff rates for special products, i.e., crude and refined palm oil, coffee, black tea, and pepper. HSL and EL are subject to annual		

				review		
	Exclusion list	1% of total trade	Do not allow	500 tariff lines	Do not allow	40 tariff lines
	Tariff reduction and elimination	Bilateral negotiations of tariff offers	Modality, subject to thresholds	Modality, subject to thresholds	Bilateral negotiations of tariff offers	Modality, subject to thresholds
	Rules of origin	Co-equal and alternative rules (RVC or CTC), with PSRs	General rule of RVC 40% and PSRs	General rule of RVC 35% or change in tariff subheading (CTSH, 6-digit HS Code) and product-specific rules	General rule of RVC (40% or change in tariff heading (4-digit HS Code) and PSRs	Co-equal and alternative rules (RVC or CTC), with PSRs
Trade in services		Separated chapter with the positive list approach on market access and national treatment	Protocol to amend the Agreement on Services signed and implemented in 2007	Provided in the Framework Agreement	Subcommittee on Services and Subcommittee on Investment established to undertake negotiations	ASEAN-Korea Trade in Services (AK-TIS) Agreement implemented in 2009 with the objective of easing restriction on various service sectors, i.e., business, construction, education, telecommunications, environment, tourism, and transportation
Investment		Chapter on investment covered protection, promotion, facilitation	ASEAN-PRC Investment Agreement implemented in 2010	Negotiations on services and investment agreements in process		ASEAN-Korea Agreement in Investment (AK-AI), signed in 2009, mainly focused on protection elements
						Measures on market access and schedules of reservations will be concluded within 5 years
Movement of natural persons		Separate chapter in relation to movement of natural persons between parties for business purposes	GATS Annex on Movement of Natural Persons applies, <i>mutatis mutandis</i>	Under negotiation	n/a	n/a
Trade facilitation		n/a	Under negotiation	n/a	n/a	No explicit Trade Facilitation
Intellectual property right		Separate chapter	n/a	n/a	Identified for economic cooperation	n/a
Dispute settlement mechanism		Separate chapter	Separate agreement	Separate agreement	Dispute Settlement Center provided (mainly focus on TIG)	AK agreement on Dispute Settlement Mechanism signed in 2005

AANZFTA = ASEAN-Australia–New Zealand Free Trade Agreement; ACCP = ASEAN Committee on Consumer Protection (ACCP); ACFTA = ASEAN-PRC Free Trade Agreement; ACIA = ASEAN Comprehensive Investment Agreement; AIA = ASEAN Investment Area; AIFTA = ASEAN-India Free Trade Agreement; AJCEP = ASEAN-Japan Comprehensive Economic Partnership; AK-AI = ASEAN-Korea Agreement in Investment; AKFTA = ASEAN-Korea Free Trade Agreement; AKTIS = ASEAN-Korea Trade in Services; AMGC = ASEAN expert group on competition; ASPEC = ASEAN Patent Search and Examination Cooperation; BIMP-EAGA = Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area; CEPT = Common Effective Preferential Tariff ; CLMV = Cambodia, Lao PDR, Myanmar, Viet Nam; CTC = change in tariff classification; CTSH = Change in Tariff Sub-Heading; EIF = Entry into Force; EL = Exclusion List; GATS = General Agreement on Trade in Services; GMS = Greater Mekong Sub-region; HSL = Highly Sensitive List; ICT = information and communication technology; IGA = ASEAN Investment Guarantee Agreement; IMT-GT = Indonesia Malaysia Thailand Growth Triangle; MNP = Movement of Natural Persons; MRA = Mutual recognition arrangement; NTBs = Nontariff barriers; NTMs = Nontariff measures; PRC = People's Republic of China; PSR = Product Specific Rules; RVC = Regional Value Content; SL = Sensitive List; SMEs = Small and Medium Enterprises; TIG = Trade in Goods.

Source: Authors' compilation.

Currently, FTAs between ASEAN and the United States (US), Gulf Cooperation Council, Canada, and Russia are being formulated. The number of dialogue partners interested in negotiating with ASEAN has increased dramatically. To ensure the appropriate manageable number of ASEAN's FTAs and CEPs, such agreements should be guided by the following key ASEAN Secretariat principles:

1. WTO consistent, e.g., tariff liberalization should substantially cover all trade, and liberalization of trade in services should be GATS Plus;
2. ATIGA, AFAS, and ACIA should serve as the basis for the FTA or CEP;
3. economic cooperation should form an integral part of the FTA or CEP; and
4. special and differential treatment should be made available in recognition of the different levels of development not only within ASEAN member states but also between ASEAN and the potential FTA partner (ASEAN Secretariat 2011b).

Hence, ASEAN's FTA and CEP are expanded as complementary to, not a substitution for, the broader picture of the WTO multilateral framework. Also, some ASEAN FTA and CEP agreements are currently overlapped by the Trans-Pacific Strategic Economic Partnership, or Trans-Pacific Partnership (TPP), which concerns the ASEAN members such as Brunei Darussalam, Singapore, Malaysia, and Viet Nam. For the ASEAN-European Union (EU) FTA, the Joint Committee agreed to pause negotiations in 2009. Both the EU and ASEAN also agreed to change tack to the bilateral level, and so the Singapore-EU FTA is the first bilateral agreement to be implemented.

These ASEAN+1 FTAs and CEP have been ratified. Their main purpose is to use ASEAN as a regional production network when exporting to third countries with special trade preferences. The Viner's Trade Creation <sup>6</sup> effect is expected to promote an increase in export volume with the lower tariff rate with the major ASEAN dialogue partners via a system of "cumulative regional rules of origin." ASEAN dialogue partners, especially multinational corporations from the more advance economies, also enjoy managing a longer supply chain between each ASEAN member with the lower cost of production. ASEAN seems to be a perfect production network under this scheme (Cave 2009, 2011).

However, one concern related to this is the trade diversion effect on foreign direct investment. Without an ASEAN+1 agreement or cumulative regional rules of origin, multinational corporations need to invest on a large scale in each ASEAN country to create enough value-added in each step of the production process. This changed when cumulative regional rules of origin (ROOs) were introduced via the ASEAN+1 agreement, because it allowed multinational corporations to reduce their investments in each country. Therefore, ASEAN members that depend heavily on foreign direct investment for economic growth may suffer from this trade diversion effect (Cave 2009, 2011).

Another concern regarding ASEAN+1 relates to the bargaining power between ASEAN and each dialogue partner, because there is no official resolution that binds all ASEAN members prior to negotiation with the dialogue partner. Hence, instead of the powerful bargaining power of the unity of 10 ASEAN member countries against

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<sup>6</sup> Trade creation is the situation when trade flows are redirected because of the formation of a free trade area or a customs union. The issue was first brought into discussion by Jacob Viner (1950), together with the trade diversion effect. After the formation of an FTA, the cost of the goods considered falls, leading to an increase in the efficiency of economic integration. Hence, trade creation's essence is elimination of customs tariffs on inner borders of unifying states (usually already trading with each other), causing further falls in prices of goods, while new trade flows may be created between states deciding to integrate economically.

one larger country, the negotiation moves forward with 10 weakly linked ASEAN members against one powerful trade partner. Some trade negotiators have expressed the view that ASEAN+1 is a bunch of 10 bilateral agreements stapled together.

To ensure the benefit to ASEAN members and to avoid the advantage given to these current and future dialogue partners, the centrality and unity of ASEAN members are the major concerns. The ability of ASEAN to position itself as a core of all ASEAN+ economic integration depends mainly on the success of members in narrowing their differences, both on economic and noneconomic issues.

In the longer term, several issues related to an increasing numbers of ASEAN+1 FTAs also need to be considered. These include (i) that more ASEAN+1 FTAs may decrease the potential of ASEAN to act as a hub of Asia, (ii) that there is controversy between “sequential” and “comprehensive” or “single undertaking” FTA negotiation methods, and (iii) what is the priority between ASEAN+1 and ASEAN++ FTAs.

## 3.2 Bilateral Trading Arrangements

For the second track to global integration, ASEAN+ is not the only regional trading arrangement committed to by member countries. ASEAN members (except Lao PDR and Myanmar) are also bound by other bilateral and regional trading arrangements. Currently, ASEAN member countries are involved with 97 such arrangements (Table 7). Most of the bilateral agreements are comprehensive, with measures on trade in goods, services, and investment as well as other types of cooperation. Each member state competes with the others to encourage the inflow of trade and investment from an extra-ASEAN country via multiple trading arrangements they are involved in. Each country’s bilateral trading agreement was signed and implemented in the hope that the country would be able to position itself as a Southeast Asian hub.

**Table 7: Association of Southeast Asian Nations Bilateral Trading Arrangements**

<b>Country/ Region</b>	<b>Implemented (Abbreviation, Year)</b>	<b>Signed (Abbreviation, Year of Signing)</b>	<b>Under Negotiation*</b>	<b>Under Consideration**</b>
ASEAN	PRC (ACFTA, 2005)		ASEAN+3	Gulf Cooperation Council (GCC)
	Australia and New Zealand (AANZFTA, 2010)		ASEAN+6	Pakistan
	India (AIFTA, 2010 TIG)		European Union (FTA)	
	Japan (AJCEP, 2008)			
	Republic of Korea (AKFTA, 2007)			
Brunei Darussalam	ATIGA (2010)		Pakistan	
	Japan (JBEP, 2007)		USA (US-Brunei Darussalam TIFA)	
	Trans-Pacific Partnership (TPP, 2006)		Islamic Conference	
Cambodia	ATIGA (2010)	USA (US-Cambodia TIFA, 2006)		
Indonesia	ATIGA (2010)	Group of Eight	EFTA (CEPA)	Chile

<sup>7</sup> ASEAN ++ is the economic cooperation between ASEAN countries and their dialogue partners, normally referred to as the East Asia Free Trade Agreement and Comprehensive Economic Partnership in East Asia.

<b>Country/ Region</b>	<b>Implemented (Abbreviation, Year)</b>	<b>Signed (Abbreviation, Year of Signing)</b>	<b>Under Negotiation*</b>	<b>Under Consideration**</b>
	Japan (JIEPA, 2008)	Developing Countries (Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan, and Turkey) (D-8, 2008)	India (CECA) Iran (PTA) Pakistan (PTA) Australia (IACEPA)	Egypt Republic of Korea (FTA) Tunisia USA
Lao PDR	ATIGA (2010)			
Malaysia	ATIGA (2010)	Chile (FTA, 2010)	Australia	Republic of Korea (FTA)
	India (MICECA, 2011)			
	Japan (JMEPA, 2006)	Group of Eight (2008)	European Union (FTA)	EFTA
	New Zealand (MNZFTA, 2010)		Turkey (FTA)	Gulf Cooperation Council (GCC)
	Pakistan (MPCEPA, 2008)		USA (TIFA)	Syria
	Trans-Pacific (TPP, 2006)		Islamic Conference	
Myanmar	ATIGA (2010)			
	BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan, Nepal)			
Philippines	ATIGA (2010)			USA (TIFA)
	Japan (JPEPA, 2008)			Pakistan
Singapore	ATIGA (2010)			
	Australia (SAFTA, 2003)	Costa Rica (SCRFTA, 2011)	Canada (FTA)	Sri Lanka
	PRC (CSFTA, 2009)	Gulf Cooperation Council (GCC)	Mexico (FTA)	UAE
	EFTA (ESFTA, 2003)		Pakistan	
	Jordan (SJFTA, 2005)		Ukraine	
	India (ISCECA, 2005)		European Union	
	Japan (JSEPA, 2002)		Egypt	
	Republic of Korea (KSFTA, 2006)			
	Australia and New Zealand (ANZSCEP, 2001)			
	Panama (PSFTA, 2006)			
	Peru (PeSFTA, 2009)			
	USA (USSFTA, 2004)			
	Trans-Pacific (TPP, 2006)			
Thailand	ATIGA (2010)			
	Australia (TAFTA, 2005)		USA (TUSFTA)	Chile
	India (ITFTA, 2006, Early Harvest)			EFTA
	Japan (JTEPA,			European Union

Country/ Region	Implemented (Abbreviation, Year)	Signed (Abbreviation, Year of Signing)	Under Negotiation*	Under Consideration**
	2007)			
	New Zealand (TNZCEP, 2005)			MERCOSUR
	Peru (Early Harvest)			
	BIMSTEC			
Viet Nam	ATIGA (2010)			
	Japan (JVEPA, 2009)		EU (Viet Nam–EU FTA)	Republic of Korea
	USA (US–Viet Nam BTA, 2001)		Chile	Customs Union of Russia, Belarus, and Kazakhstan (FTA)
	Trans-Pacific (TPP, 2006)			EFTA

\* Framework agreement already signed. \*\* Agreement proposed but framework not yet signed.

AANZFTA = ASEAN-Australia-New Zealand Free Trade Agreement; ACFTA = ASEAN-PRC Free Trade Agreement; IFTA = ASEAN-India Free Trade Agreement; AJCEP = ASEAN-Japan Comprehensive Economic Partnership; AKFTA = ASEAN-Korea Free Trade Agreement; ANZSCEP = Australia New Zealand Singapore Closer Economic Partnership; ATIGA = ASEAN Trade in Goods Agreement; BIMSTEC = Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation; BTA = Bilateral Trading Agreement; CCEA = Comprehensive Economic Cooperation Agreement; CEPA = Comprehensive Economic Partnership Agreement; CSFTA = PRC-Singapore Free Trade Agreement; EFTA = European Free Trade Association; ESFTA = EFTA-Singapore Free Trade Agreement; FTA = Free Trade Agreement; GCC = Gulf Cooperation Council; IACEPA = Indonesia-Australia Comprehensive Economic Partnership Agreement; ISCECA = India-Singapore Comprehensive Economic Cooperation Agreement; JBEPA = Japan-Brunei Darussalam Economic Partnership Agreement; JIEPA = Japan-Indonesia Economic Partnership Agreement; JMEPA = Japan-Malaysia Economic Partnership Agreement; JPEPA = Japan-Philippines Economic Partnership Agreement; JPEPA = Japan-Singapore Economic Partnership Agreement; JTEPA = Japan-Thailand Economic Partnership Agreement; JVEPA = Japan-Viet Nam Economic Partnership Agreement; KSFTA = Korea-Singapore Free Trade Agreement; MICECA = Malaysia-India Comprehensive Economic Cooperation Agreement; MNZFTA = Malaysia-New Zealand Free Trade Agreement; MPCEPA = Malaysia-Pakistan Comprehensive Economic Partnership Agreement; PeSFTA = Peru-Singapore Free Trade Agreement; PRC = People's Republic of China; PSFTA = Panama-Singapore Free Trade Agreement; PTA = Preferential Trading Agreement; SAFTA = Singapore-Australia Free Trade Agreement; SCRFTA = Singapore-Costa Rica Free Trade Agreement; SJFTA = Singapore-Jordan Free Trade Agreement; TAFTA = Thailand-Australia Free Trade Agreement; TIFA = Trade and Investment Framework Agreement; TIFTA = Thailand-India Free Trade Agreement; TNZCEP = Thailand-New Zealand Closer Economic Partnership; TPP = Trans-Pacific Partnership; TUSFTA = Thailand-US Free Trade Agreement; UAE = United Arab Emirates; USA = United States of America; USSFTA = US-Singapore Free Trade Agreement.

Source: Authors' Compilation.

At present, each ASEAN member is tied to both bilateral and ASEAN+ trading agreements. In the short term, each member may commit itself to the agreement that gives the best economic benefit. In the long run, therefore, apart from the AEC target of being a region fully integrated into the global economy, one of the important challenges is ensuring that each member's bilateral trading arrangements serve ASEAN as a building block rather than a roadblock to greater ASEAN economic integration.

### 3.3 Region-Wide Economic Integration

ASEAN's interest in broader trading arrangements is one of the major outcomes of such changing environment and challenges. Recently, ASEAN and its trading partners discovered the complexities related to the proliferation of five ASEAN+1 and bilateral FTAs, which became known as the "Asian noodle bowl" effect (Baldwin 2007). It was thought that a region-wide FTA would be a good solution to solve such problem (Chirathivat 2004, Kawai and Wignaraja 2009c). However, thinking on how to achieve a such an FTA differs at the regional level. One proposal starts with an



East Asian FTA (known as EAFTA) among ASEAN+38 countries and then extending it gradually to ASEAN+6 countries and others; another idea proposes including all ASEAN+6 countries in a region-wide FTA or comprehensive economic partnership in East Asia (known as CEPEA) from the start. For the moment, both proposals are moving, in parallel, with which ASEAN is regarded both as the FTA club and as the driving force of regional economic integration.

Until ASEAN+1 FTAs are developed and joint studies on a region-wide FTA in East Asia in which the PRC, Japan, and the Republic of Korea assume an active role are undertaken, competition and rivalries among the three countries (which played a positive role in the ASEAN+1 FTAs) could turn into a stumbling block to advancement of a region-wide FTA. The lack of FTAs between the PRC, Japan, and the Republic of Korea would be a fundamental problem. In this case, the role of ASEAN in forging broader trading arrangements in East Asia looks important and prominent, even without a completely coherent view among ASEAN members. ASEAN will be subject to increasing pressure to respond to the growing and urgent need for such region-wide trade agreements. ASEAN has to play an active role in helping achieve a region-wide FTA that suits the group interests, in particular the deepening of the AEC, and other countries (Australia, the PRC, India, Japan, the Republic of Korea, and New Zealand) as they move into different stages of regional economic integration.

The initiative in favor of East Asian regionalism began in 1990 with Malaysian Prime Minister Mahathir Mohammed's proposal. However, the proposal excluded, and so was blocked by, the US, which preferred to use APEC for its dialogue with all East Asian economies. With the US, Japan threatened not to join the East Asian Economic Caucus. The PRC was viewed as being too preoccupied with its own transition to a market economy to give serious thought to such an initiative. All of these factors gave rise to further thought by East Asian countries, including ASEAN.

Today's broader region building, in which ASEAN plays an increasing role, started to take shape after the Asian financial crisis of 1997–1998. It started with regional monetary cooperation, known as the Chiang Mai Initiative, which gave birth to the process of ASEAN+3, comprising ASEAN plus the PRC, Japan, and the Republic of Korea. At the initiative of the Republic of Korea early in the new century, this process was expanded to cover other areas of economic cooperation, the most notable example being the East Asian Free Trade Area (EAFTA), of which the PRC was an important supporter at a later stage. In the meantime, ASEAN took further steps to strengthen and broaden regional cooperation in 2005 when the first East Asia Summit was convened. At this point Japan saw the opportunity to propose another comprehensive economic partnership in East Asia (CEPEA, also known as ASEAN+6). As a result, ASEAN has become host to both ASEAN+3 and ASEAN+6 as key initiatives aiming to broaden regional economic cooperation in East Asia.

Since then, the East Asia Summit has also developed its own platforms for leaders to discuss various regional and global issues related to development of the region. It also has summits with ASEAN+3 with the only differences being the number of countries participating and the issues they select to discuss. Overall, the two processes (EAFTA and CEPEA) have created real questions in East Asia, if not great confusion, about the way people look at the region, and have complicated the regional institutional landscape.

From an economic perspective, if economic integration is pursued through formation of regional trading arrangements, ideally the larger the grouping the greater will be

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<sup>8</sup> ASEAN+3 (or ASEAN Plus Three) is a forum that functions as a coordinator of cooperation between ASEAN and the three East Asian nations of the People's Republic of China, Japan, and the Republic of Korea.

the gains to its members as a result of trade liberalization, and the greater the specialization and economies of scale, but this will come at the expense of nonmembers (Table 8). According to study results (Urata 2008), the East Asian economies will benefit from the agreements as they can expect their combined gross domestic product (GDP) to increase by 2.05% under the EAFTA and 2.11% under the CEPEA, with an overall increase in ASEAN of 5.89%.

**Table 8: Effects of East Asian Free Trade Agreements and Comprehensive Economic Partnership in East Asia on Gross Domestic Product (%)**

Country/Region	EAFTA (ASEAN+3)		(ASEAN+1) x5	CEPEA (ASEAN+6)	
	Sim.1	Sim.2		Sim.1	Sim.2
Japan	0.44	0.44	0.10	0.54	0.54
PRC	1.66	4.72	0.20	1.77	4.84
Korea, Rep. of	3.56	3.55	0.20	3.72	3.71
Indonesia	1.74	3.94	1.00	1.94	4.14
Malaysia	5.83	8.62	3.30	6.21	9.00
Philippines	3.94	6.28	2.20	4.18	6.52
Singapore	4.22	4.24	2.30	4.40	4.42
Thailand	4.49	7.02	2.80	4.78	7.32
Viet Nam	7.08	9.67	5.00	7.33	9.92
Other SEAs	0.88	2.91	0.50	0.92	2.95
Australia	(0.09)	(0.09)	0.20	1.35	1.35
New Zealand	(0.06)	(0.06)	0.10	1.87	1.87
India	(0.10)	(0.10)	0.50	1.30	3.45
Hong Kong, China	0.00	0.00	0.00	(0.01)	(0.01)
Taipei, China	(0.08)	(0.08)	0.00	(0.10)	(0.10)
NAFTA	(0.01)	(0.01)	0.00	(0.01)	(0.01)
EU15	(0.01)	(0.01)	0.00	(0.01)	(0.01)
Rest of the World	(0.06)	(0.06)	0.00	(0.08)	(0.08)
ASEAN	3.60	5.67	2.14	3.83	5.89
ASEAN+3	1.18	1.93	0.30	1.30	2.05
ASEAN+6	1.02	1.68	0.31	1.30	2.11
World	0.22	0.38	0.06	0.28	0.47

( ) = negative value.

EAFTA = East Asia Free Trade Agreement; ASEAN + 3 = ASEAN + PRC + Japan + Korea; ASEAN +1 x 5 = ASEAN PRC FTA, ASEAN Korea FTA, ASEAN India FTA, ASEAN Australia New Zealand FTA, ASEAN Japan Comprehensive Economic Partnership; CEPEA = Comprehensive Economic Partnership for East Asia = ASEAN + 6 = ASEAN + PRC + Japan + Korea + Australia + New Zealand + India.

Note: simulation 1 = trade facilitation and liberalization; simulation 2 = trade facilitation and liberalization, and economic cooperation.

Source: Urata (2008).

The importance of economic cooperation can be observed by comparing the results from simulation 1 (trade facilitation and liberalization) with simulation 2 (trade facilitation and liberalization, and economic cooperation). GDP growth rates of developing members are supposed to increase substantially when economic cooperation is included in the program.

However, formation of a region(wide trading arrangement will better serve the region only if it institutes greater discipline than the web of bilateral trading arrangements. It remains true that most bilateral FTAs could lead to significant trade diversion effects, particularly because of stringent regulations related to the rules of origin, custom procedures, and others, and could turn out to be undesirable for the dynamic development of regional and global production networks involving all East Asian economies.

Another study of ASEAN's role as the hub of Asian trade agreements (Petri 2009) argued that ASEAN's role was not just economic but also political-economic. ASEAN is a collection of smaller countries, and thus is a relatively neutral participant in the competitive structure of emerging Asia, and yet is a nonthreatening partner to many

larger countries with which it has good economic ties such as the PRC, Japan, and India. The main question that remains is how ASEAN will benefit from such an expanding FTA hub. By using another major comprehensive study (Kawai and Wignaraja 2008) estimating the benefits of establishment of ASEAN+1, as well as more comprehensive frameworks involving ASEAN+3 and ASEAN+6 countries, the same authors extrapolate their work to FTAs that they did not analyze, including with other potential partners such as Australia, New Zealand, India, the United States, and the EU.

The results show substantial income gains of 6.83% for ASEAN+1 FTAs, consistent with the region's openness and the relatively high barriers that still apply to its trade with major partners. If Australia, New Zealand, India, the United States, and the EU are added, ASEAN's overall gains from its FTA hub would rise to 10.31%. The benefits are especially large for Malaysia, Thailand, and Viet Nam—economies with strong trade connections with northeast Asia and with a strong presence of industries dominated by production networks. The benefits of ASEAN+1 FTAs are mostly attributable to trade creation and not trade diversion. However, the same benefits of FTAs could also increase significantly if they were implemented fully by ASEAN+3 and ASEAN+6. These comprehensive FTAs would differ from the ASEAN hub arrangement by also liberalizing trade among northeast Asian economies. ASEAN's gains are likely to be somewhat smaller in a broad regional FTA than in a hub system since, in the latter, ASEAN enjoys preferential access in the ASEAN+1 FTAs with northeast Asia over northeast Asian competitors. However, ASEAN's loss is small compared to its potentially large gain from a broad Asian FTA, suggesting that the ASEAN hub will ultimately accelerate the formation of large Asian groups (Petri 2009). This outcome would be beneficial for Asia and the world as a whole.

Even though a broad regional FTA might not have an overall significant impact on ASEAN+1 FTAs, it could cause many of the bilateral FTAs and even ASEAN+1 FTAs to lose their meaning for the business sector. Whether this broad regional FTA represents a “self-destruct” path for other types of FTAs is a very important issue, and one for which ASEAN has to provide a clear answer. It is for this reason that ASEAN needs to consider the special and differential advantages not really presented in the region-wide FTA. At the policy level, there is also the issue of centrality; if ASEAN loses its hub status it could also lose attractiveness to outside investors. Already the region has to compete with economic activity moving northwards to the PRC, Japan, and the Republic of Korea, and westwards to India. The issue of ASEAN centrality is becoming crucial for ASEAN in terms of its hub status. ASEAN as a whole needs to address the issue by deepening its own integration process beyond the AEC to counterbalance a possibly reduced role of ASEAN in a region-wide FTA.

## **4. MAJOR CHALLENGES FACING THE ASSOCIATION OF SOUTHEAST ASIAN NATIONS ECONOMIC COMMUNITY**

### **4.1 Major Challenges in Realizing the Association of Southeast Asian Nations Economic Community 2015**

#### **4.1.1 Common External Tariff Rates and Rules of Origin**

An increasing number of both ASEAN member country bilateral trading agreements and ASEAN+1 FTAs have led to the so-called “Asian noodle bowl” effect. Cumulating rules are also very important for a region with a lot of potential multi-country value

adding. However, the problem at this point is that cumulating rules are inherently complex and, given ASEAN's history of either low or non-utilization, the complexity is unnecessary. Theoretically, moving toward deeper economic integration by negotiating the common external tariff scheme may be needed to resolve all complications related to international trade with the current complex and unfriendly rules of origin. Unfortunately, ASEAN member countries do not have any plan, at least before 2015, to negotiate on this issue.

In the longer term, the Asian noodle bowl effect and the need for an ASEAN common external tariff scheme may subside when the most-favoured-nation (MFN) tariff rate between ASEAN members reduces under the WTO tariff reduction scheme. The view is that a rule of origin (ROO) waiver can automatically be given whenever the MFN tariff rate between the importing and exporting countries is the same (ASEAN may set its own benchmark of, say, both 10%) or within a given range of each other, such as, say, 3 percentage points (e.g., 10% and 7%). This would in effect abolish rules of origin for a large part of intra-ASEAN trade (Adams et al. 2003; Lloyd 2011). Moreover, this decline in MFN tariff rate may allow ASEAN to envisage a customs union, with temporary sector exclusions as is the case with the CEPT. To implement this, ASEAN members should start with consumer products or cover only luxury products rather than raw materials, intermediate products, and capital goods. Flexibility and some concession can be allowed for Cambodia, the Lao PDR, and Myanmar.

#### **4.1.2 Nontariff Barriers**

Removal of nontariff barriers is indeed one of the most important elements of the AEC Blueprint in order to move ASEAN toward the goal of being a real single market (Narjoko, Intal, and Hin 2011). Currently, the ambiguous NTMs such as quotas, non-automatic import licensing, import administration, various technical regulation and product standards, and sanitary and phytosanitary measures are sometimes considered the barrier to trade in goods. To realize the free flow of trade in goods among ASEAN members, targets were set to remove all NTBs by 2010 for Thailand, Malaysia, Singapore, Indonesia, and Brunei Darussalam, by 2012 for the Philippines, and by 2015 (with flexibility to 2018) for the CLMV countries. Unfortunately, the verification and cross-verification of NTBs among ASEAN members is still being processed. A database of tariff equivalents to ASEAN's NTMs is also needed to ease the NTB elimination process (Srisangnam 2007). With the complexity of NTMs and NTBs, full elimination of all NTBs among ASEAN members is expected to be delayed unless ASEAN leaders have the joint political will to solve the problem.

#### **4.1.3 Trade Facilitation**

"There is limited room for tariff reduction despite its well-recognized effects; therefore the current focus of ASEAN in trade facilitation is demonstrably rewarding" (Urata and Okabe 2011: iv). The ASEAN working group on rules of origin, tariff nomenclature, and customs procedures has also concluded. By 2015, we expect that the ASEAN single-window systems will be enabled and accessible. It is expected that the more complex issues—such as customs, trade procedures, standards and conformance, and sanitary and phytosanitary issues—will be solved prior to 2015. At this stage, port efficiency and the customs environment should be priority areas for capacity development (Urata and Okabe 2011). However, in the longer term, the three major mechanisms ASEAN needs to conclude to help realize the single market are the rules of origin, MRAs, and harmonization of standards and technical regulations.

As mentioned above, to realize the single market and promote the real free flow of goods needed to establish ASEAN as a production base on the world market, simpler

and more user-friendly rules of origin are required immediately (Wakamatsu 2004). The self-certification scheme needs to be established in the medium term. The costs of ROO compliance must be minimized, and ROOs made liberal enough to have a greater impact on regional growth and integration (Medalla and Rosellon 2011).

Apart from ROOs to guarantee the origin of the goods traded among ASEAN members, MRAs also play a major role in guaranteeing the goods in terms of product standard. MRAs will not only reduce the business costs from product qualification testing but also help reduce the imposition of NTBs among ASEAN members. Thus far, ASEAN has concluded only two sector MRAs—the electrical and electronics sector, and the cosmetics sector (ASEAN Secretariat 2011a). Therefore, more MRAs—especially ones that set the standard for intra-ASEAN top-traded products—need to be set by 2015.

Along with MRAs, harmonization of standards and technical regulations will also help reduce the technical barriers to trade among members. According to the 2011 AEC fact book (ASEAN Secretariat 2011c), 58 standards for electrical appliances and three standards for rubber-based products were harmonized (ASEAN Secretariat, 2011c). Progress has also been reported in the pharmaceutical sector. The harmonization of technical regulations for agro-based products, automotive, medical devices, traditional medicine, and health supplement industries are the next target. Much work remains to be done to cover the most important products which are heavily traded among ASEAN countries before the realization of the AEC in 2015. To gain the maximum benefit, ASEAN standards and technical regulations need to be set not only in concordance with each ASEAN member's domestic standard, but also need to be consistent with recognized international industrial standards.

#### **4.1.4 Narrowing the Development Gap Within the Association of Southeast Asian Nations**

The liberalization of trade in goods cannot happen unless there are bridging measures to narrow the gap in two dimensions. The first is that ASEAN still needs a set of effective measures to realize the convergence in economic development among its members. Secondly, ASEAN small and medium-sized enterprises (SMEs) are the major driving force of regional development, and the diversity of SMEs in term of economic size, business nature, and nationality is another major concern.

ASEAN connectivity is another development area that helps towards the realization of AEC 2015. Physical transportation networks have been developed and are nearly complete, but the policies that help facilitate international trade along these routes are still far from fully implemented. According to the survey conducted by JETRO in 2011, cross-border transportation agreements among Greater Mekong Subregion ASEAN members were already signed but not yet fully implemented (JETRO 2011). The survey revealed that officers at Thai border posts with the Lao PDR and Cambodia are not yet ready to implement these agreements (Srisangnam and Sermcheep 2011).

#### **4.1.5 Trade in Services**

Since WTO agreements bind all members to decreasing the barriers in trade in goods, ASEAN FTAs need to focus more on the liberalization of trade in services and investment. For trade in services, the rules of origins or the so-called “business substantial operations” for identifying the nationality of ASEAN services firms are required to promote ASEAN investments in mode 3 of service supply. For mode 4 of service supply, the whole set of MRAs guaranteeing the standard of professional workers allowed to move across borders needs to be carefully negotiated. Mutual recognition agreements can help but the removal of beyond-the-border measures

and harmonization of rules and regulations are the next step in ensuring the national treatments of ASEAN and local professional workers. To realize a real free flow of services by 2015, ASEAN may need to adopt a new approach to liberalizing trade of services (Soesastro 2007b; Dee 2011).

#### **4.1.6 Investment**

ASEAN also plans to be a production network by linking investors and multinational corporations from the more developed partners to the higher efficiency producers in the emerging economies, and then exporting to third countries with high purchasing power via the system of ASEAN+1 FTAs. To realize this goal by 2015, the rules of origin, self-certificate system, and trade facilitations need to be more user-friendly and accessible, with lower transaction costs. Moreover, ASEAN+1 FTAs need to be negotiated consistent with the ASEAN Comprehensive Investment Agreement (ACIA).

#### **4.1.7 Economic, Monetary, and Fiscal Cooperation**

According to the study by Bank Indonesia, ASEAN may not yet be ready to form an economic and monetary union with a common currency (Simorangkir 2011). However, according to the discussions of a group of young professionals from central banks and monetary authorities from ASEAN and Timor-Leste (excluding Singapore and Brunei Darussalam), regional cooperation between the ASEAN central banks and financial authorities is required for the following reasons. Firstly, as deeper and broader economic integration among ASEAN members occurs, one country's policy may affect that of another. Secondly, massive capital inflows to ASEAN countries could potentially create an asset price bubble and complicated monetary management. Finally, the heightening global risk (especially from the US and EU) may trigger a sudden reversal of the flow of investment and place pressure on asset prices and exchange rates. Therefore, at least three areas of regional financial and monetary cooperation are needed—monetary and exchange rate policy, capital flows management, and regional financial safety nets (Simorangkir 2011; Khiaonarong 2011).

The experiences of the EU give pause for thought about the merits of pushing for more integration without analysis of the consequences. ASEAN would be ill-advised to completely follow the EU down the path of monetary integration without significantly harmonized fiscal policies. ASEAN also needs an EU-type growth and stability pact with an institution to monitor, facilitate, govern, or even penalize members who cannot maintain the pact. Macroeconomic policy coordination and non-rival fiscal policies, e.g., competition on lowering corporate taxes to encourage an inflow of foreign direct investment (FDI) among ASEAN members, are the first of many requirements to realizing deeper economic integration. At the latest ASEAN summit, ASEAN leaders started discussions about emphasizing the importance of complementing domestic macroeconomic policy with regional and global macroeconomic coordination and financial cooperation, as well as strengthening macroeconomic coordination and promoting financial cooperation at the regional and global level. The Bali Concord III is just the beginning of good governance in macroeconomic policy coordination. As the plan is yet to be negotiated, ASEAN has to wait to realize this objective.

#### **4.1.8 Other Integration Areas**

For the other areas of economic integration among ASEAN members, there are some critical issues to be dealt with in realizing AEC 2015. According to the latest AEC scorecard (1 January 2008–30 April 2011), ASEAN has completed 67.9% of all measures due under the AEC for the two phases under review (ASEAN Secretariat

2011b). Nontariff measures, standards and conformance, and service sectors are the elements of the AEC Blueprint that need to be liberalized as a priority group (Narjoko, Intal, and Hin 2011). Nevertheless, most of the measures committed to by ASEAN members “either are too general or have gaping loopholes that allow member-states to wiggle out of their commitments. Even those listed above would be difficult to carry out either for technical, bureaucratic, economic or political reasons” (Severino 2010). Hence, there must be some mechanism to make a member take this commitment to ASEAN more seriously.

The structure of the ASEAN Secretariat and intergovernmental methods also need to be considered in reaching the AEC by 2015.

ASEAN is largely still a voluntary organization with decisions being taken in consensus manner...there is a serious lack of capacity in ASEAN to enforce its decisions either at the regional or at the national level. Moreover, in many places, the blueprint remains vaguely defined, and “milestones” are missing. Some details of the plan have been left out, perhaps in recognition of the fact that an agreement on several aspects of “community building” cannot be reached until there is greater confidence in the process and the existence of a development gap amongst member countries. (Severino, Shrestha, and Das 2010)

Currently, implementing the full AEC scheme by 2015 will be “technically and politically difficult” (Plummer and Chia 2009) unless both the political participants and all participants from ASEAN member countries make stronger efforts.

## **4.2 Attempts to Broaden Free Trade Agreements in East Asia**

### **4.2.1 The East Asia Free Trade Agreement and Comprehensive Economic Partnership in East Asia Proposals**

By the time the ASEAN economy ministers met in Thailand in August 2009, two reports had been submitted to them through their senior economic officials (as ASEAN prepared such reports for the leaders' meetings of both ASEAN+3 and ASEAN+6 later that same year):

1. Report of the Joint Expert Group on the EAFTA Phase 2 Study; and
2. Track Two Study on Comprehensive Economic Partnership for East Asia: Phase 2.

Both reports are recommendations in the study on the EAFTA with regard to the study of the CEPEA, with the view to guiding the senior economic officials meetings as it deliberated on possible recommendations to the ministers. The recommendations arising from the Phase 1 and 2 studies for the EAFTA and for the CEPEA can be summarized as follows:

1. For the EAFTA, the Phase 1 study proposed that (a) the EAFTA proceed within the ASEAN+3 framework because it has already established a solid foundation; (b) the EAFTA be of high quality that will lead to further deepening of economic integration, enhancing the competitiveness of production networks and progressively reducing the development gaps among East Asian countries; and (c) economic development cooperation initiatives with specific action plans must be adopted. For the Phase 2 study, the East Asian leaders put the EAFTA on the economic agenda as an important initiative during the 13th ASEAN+3 Summit in 2009 and proposed that (a) the process to form an EAFTA should follow immediately; (b) a gradual and realistic strategy be pursued to achieve a desirable and feasible EAFTA; (c) initially the EAFTA be formed by consolidating the existing FTAs, undertaken to incorporate trade in services and investment, with concrete trade and

investment facilitation measures, to fully realize the benefits of an EAFTA; (d) two working groups be immediately created to pave the way for an EAFTA, one to design a unified regime of rules of origin for the EAFTA, and another to look into tariff nomenclature and other customs-related issues; and (e) the overall EAFTA negotiations be launched by 2012, at the latest.

2. For the CEPEA, the Phase 1 study stated the objectives as being to (a) deepen economic integration in the region, (b) help narrow the development gap, and (c) achieve sustainable development. Structurally it proposed that the CEPEA comprise the three pillars of economic cooperation, trade and investment facilitation, and trade and investment liberalization, and that this be affirmed by the leaders. The study proposed that (a) discussions be commenced among East Asian governments on cooperation and facilitation measures under the CEPEA; (b) necessary decisions be made regarding an FTA under the CEPEA, i.e., whether to commence a government process immediately, provide a clear timeline for future negotiations, or continue to further detailed study; and (c) a mechanism be developed for enhancing the opportunity for regional business leaders to contribute to the CEPEA process. The Phase 2 study reaffirmed the CEPEA's objectives and structure at the leaders' level, and that the study and discussion on concrete steps to realize the CEPEA as a comprehensive framework that includes cooperation, facilitation, and liberalization commence immediately among member country governments.

#### **4.2.2 Outcomes from Recommendations**

It can be seen that the recommendations in the Phase 1 studies for the EAFTA and the CEPEA are not that far apart. To highlight a few points, both studies stated the following:

1. They place emphasis on a high-quality FTA to further deepen economic integration and narrow development gaps among the countries participating in the relevant FTA.
2. They suggest that the FTA be based on three pillars: (a) liberalization of trade (goods and services) and investment, (b) trade and investment facilitation, and (c) development and economic cooperation. The EAFTA went further, suggesting that an institutional framework for broad-based policy dialogue among the members be put in place to support development cooperation. On the other hand, the CEPEA study specified environment, energy, logistics, and facilitation issues covered by the AEC Blueprint as important areas for cooperation and facilitation.
3. They suggest a consolidation of related existing FTAs with the CEPEA. Recognizing that this consolidation may take a while, they suggest voluntary liberalization of barriers and regulatory reforms through information exchange and monitoring.
4. They advocate open regionalism for both studies.

The rationale behind the current global financial crisis gives countries in the region the impetus to broaden economic integration. Meanwhile, recognizing the proliferation of FTAs in East Asia, consolidation and streamlining of these FTAs should be a good thing, and will have to be undertaken at some point in order to get maximum benefits—in principle, the bigger the FTA grouping is, the greater the economic gains would be.

1. When it comes to Phase 2 of both studies, the recommendations could generally be described as follows:



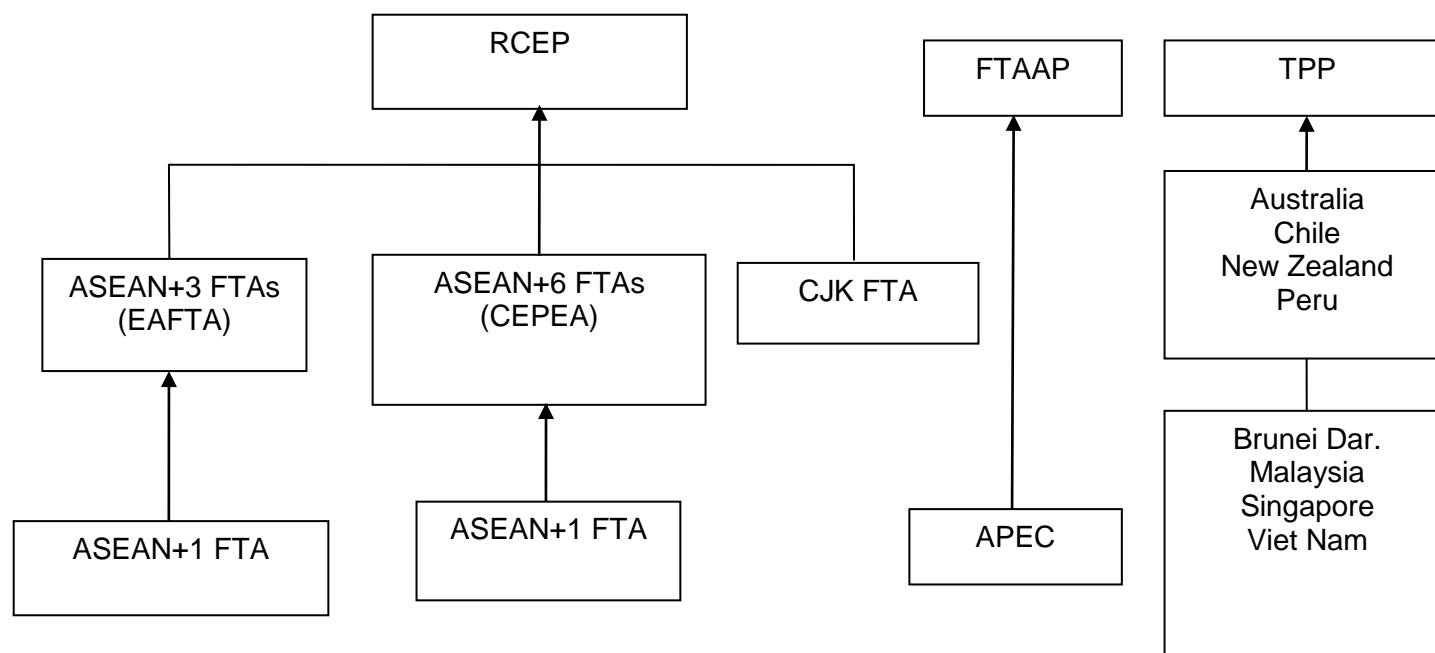
2. Pursuit of broader regional economic integration in East Asia, realizing that the grouping has a greater potential for generating welfare gains for all partners in the region because of the inclusion of more developed and emerging economies.
3. Consolidation of the existing ASEAN+1 FTAs, based on a more practical approach, rather than negotiating a whole new agreement as a way to alleviate concerns over the “noodle bowl” effect of the overlapping FTAs in the region. Northeast Asia, which could be a factor in the EAFTA, has to make substantial progress with some kinds of FTA(s) between the PRC, Japan, and the Republic of Korea, often known as the PRC–Japan–Korea FTA (or CJK FTA). Lesser-developed ASEAN countries, particular the CMLV countries, might not be prepared to extend to the other East Asian countries the same tariff treatment they are giving to ASEAN, so the consolidation process into an ASEAN+3 FTA must take into consideration some of the sensitive issues. Only when both an ASEAN+3 FTA and a CJK FTA are in place can an EAFTA be achieved by consolidating the two.
4. Elevation of the EAFTA and CEPEA track two process to a track one process, which, in fact, was done at the ASEAN economic ministers meeting in Thailand in August 2009, followed by the acceptance by their leader summits.

The track one process declared to work in parallel on recommendations of both reports. The governments began the process of setting up four working groups related to the important issues of rules of origin, customs procedures, tariff nomenclature, and economic cooperation. However, the rationale in all these related issues still depends upon the following:

1. For rules of origin, an important task is to create a unified rules of origin regime that is simple, liberal, and facilitates trade.
2. With regard to liberalization in the trade of goods, instead of renegotiating tariff elimination and schedules, it would be more reasonable to focus on reduction of discrimination arising from the implementation of multiple tariff concessions. This could be achieved by harmonizing (to the extent possible) tariff commitments made in AFTA, then ATIGA, and existing ASEAN+1 FTAs.
3. As for trade in services and investment, the agreements are feasible in light of similarities in the existing structure of agreements.
4. Trade and investment facilitation measures as well as cooperation programs are not regionally coordinated and overlap one another, so the grouping could focus on concrete facilitation and cooperation measures, particularly with a view to helping less-developed countries such as Cambodia, Myanmar, the Lao PDR, and Viet Nam.

However, there is a view that all these developments should be based upon a more realistic and achievable approach before moving on to high-quality trade and investment liberalization, comprehensive facilitation, and cooperation measures. Consolidation of existing ASEAN+1 FTAs and progress on the CJK FTA become an important step towards broader regional trading arrangements in East Asia (Figure 1). Different approaches should be allowed for less-developed countries, particularly Cambodia, Myanmar, the Lao PDR, and Viet Nam. The inclusiveness issue remains important, like the way the ASEAN+3 countries will work with India, Australia, New Zealand, and possibly more countries as the interests in the grouping are expanding rapidly with an emerging Asia in the global economy

**Figure 1: Conceptual Formation of a Regional Comprehensive Economic Partnership in Relation to an East Asian Free Trade Agreement and Comprehensive Economic Partnership in East Asia**



FTA = Free Trade Agreement, EAFTA = East Asian Free Trade Agreement, CEPEA = Comprehensive Economic Partnership for East Asia, CJK FTA = China-Japan-Korea Free Trade Agreement, RCEP = Regional Comprehensive Economic Partnership, APEC = Asia-Pacific Economic Cooperation, FTAAP = Free Trade Agreement of Asia-Pacific, TPP = Trans Pacific Partnership.

Source: Authors' compilation.

### 4.2.3 Regional Comprehensive Economic Partnership

While there is no one-size-fits-all template for ASEAN attempts to broaden regional agreements in Asia, there are, however, persistent efforts to develop in parallel the EAFTA and CEPEA proposals. As shown from the EAFTA and CEPEA process and outcomes, ASEAN's attempt to broaden regional integration in Asia is starting to take shape, but is still far from complete. Since the beginning of 2010, officials from ASEAN, ASEAN+3, and ASEAN+6 have been working on issues related to rules of origin, tariff nomenclature, custom procedures, and economic cooperation. Several meetings have been held, with each working group making good progress on its agenda.

The crucial issue remaining to be settled is the “Asian noodle bowl” problem. For this reason, any future comprehensive and gradual approach to broadening regional integration, whether it is EAFTA or CEPEA, will need to tackle the complexity related to existing FTAs, in particular the ASEAN+1 and bilateral FTAs which have hampered utilization. As such, ASEAN with other interested partners needs to find the best way to facilitate an early framework agreement to address at least the issues such as rules of origin and tariff nomenclature.

Fortunately, the idea of creating a regional comprehensive economic partnership (RCEP), following the 18th ASEAN Economic Ministers’ Retreat in February 2011 in Nay Pyi Taw, was introduced and then gained momentum after the ASEAN Leaders Summit in Bali in November 2011. Since then, opportunities for ASEAN senior economic officials to work on the scope of potential RCEP partners and its framework occurred during the 44th ASEAN Economic Ministers’ Meeting in August 2012, where all ASEAN+6 countries agreed to such an RCEP by setting negotiations to start in early 2013 and be completed by the end of 2015.

For instance, the RCEP is a new ASEAN-led FTA linking Southeast Asia with all of the “+6” countries—Australia, the PRC, India, Japan, the Republic of Korea, and New Zealand. In its design, ASEAN leaders have planned to adopt an open accession scheme that will allow other countries to join as new members provided they can comply with the grouping’s rules and framework. In this sense, membership is open to other countries, although it will start with the ASEAN+6 countries. In principle, the RCEP will help ASEAN to cement its central role in the emerging broader regional integration architecture and seek to reduce the complexities of the “Asian noodle bowl” effects of all existing FTAs. In the longer run, this agreement will help to promote broader regional integration consistent with the multilateral trading system, while departing from the complexities of the small scope of other bilateral FTA arrangements.

Meanwhile, the RCEP is supposed to have a wider framework that includes trade in goods, trade in services, investment, trade and business facilitation, intellectual property rights, economic and technical cooperation, competition policy, and dispute settlement. Given the wide diversity among ASEAN countries—particularly the developing members such as Cambodia, the Lao PDR, Myanmar, and Viet Nam—the RCEP process would fall into a lowest-common-denominator trap of trying to accommodate all countries with a bare minimum level of liberalization, and ASEAN must ensure this does not happen. On the other hand, a very strong position from ASEAN in the RCEP is needed to show a continuation of incremental efforts from the grouping in making a region-wide system, e.g., rules of origin to working with a view that this would also serve ASEAN’s centrality and deeper integration of the AEC. The option for firms set up in ASEAN (whether local or foreign) to take advantage of regional trade and investment agreements will augment as these agreements will affect firm competitiveness. Helping to set up a truly borderless AEC is crucial to helping ASEAN firms position themselves better with firms in countries such as the PRC and India. Also, the RCEP is potentially an important initiative for the region at a time when the United States

continues to struggle with economic recovery and fiscal cliffs, and Europe still faces prolonged economic uncertainties.

The ASEAN Summit in Phnom Penh in October 2012 reaffirmed the stand of the ASEAN Framework for Regional Comprehensive Economic Partnership (RCEP), adopted in 2011. However, it remains for ASEAN to encourage all countries to deepen discussions toward a successful conclusion of the partnership. Steering such an important initiative into concrete action represents a very important challenge for ASEAN, given the past limitations of the grouping. It is important for ASEAN to play its central role in the formation of the RCEP, making sure of its success that will support implementation of the AEC and beyond. In the end, ASEAN needs to ensure that the RCEP becomes a key pillar in Asia's broader regional economic architecture.

Though considered a new important initiative for the region, there are, however, questions around future commitments to trade liberalization among the countries involved. Some have even gone far to anticipate a low level of trade liberalization for the RCEP. This is due to the so-called "ASEAN way," in which no member will adopt trade policies when there are disagreements and very often, due to different levels of development, some members would argue for protection of sensitive industries against increased competition. Although this flexibility may help to attract the less-developed countries to the grouping, a low level of trade liberalization may leave further trade impediments and discourage greater and broader regional integration in the longer run.

Nevertheless, the main exercise for the RCEP, at least initially, remains the consolidation of all ASEAN+1 FTAs and bilateral trade agreements. In effect, members of the RCEP believe they will benefit from such an agreement as long as the scheme continues to develop. ASEAN countries are expected to streamline their existing FTAs and gain greater access to other non-ASEAN countries, whether this is the ASEAN+3 countries—the PRC, Japan, and the Republic of Korea—or the ASEAN+6 countries—Australia, India, and New Zealand. At the same time, the RCEP is expected to encourage more investment flows from more-developed regions to less-developed ones and integrate them into regional production networks.

#### **4.2.4 Implications of an Expanded Trans-Pacific Partnership**

The development of the Trans-Pacific Partnership (TPP) in 2006, an effort to tie economies along the Pacific into a free trade area, also poses a major concern for ASEAN, particularly regarding ASEAN's centrality and its driving force in the RCEP. The issue remains how these latest developments could impact the process of broader regional arrangements, as ASEAN is taken its leading role more seriously.

The TPP was advanced as an alternative to the Asia-Pacific trade and investment liberalization in view of the failure of the "soft" approach of region building by APEC. Currently, the TPP includes Brunei Darussalam, Chile, New Zealand, and Singapore. In 2009, the United States (US) committed to engage with the TPP to shape this broad-based regional agreement. Since then, the US, Australia, Malaysia, Viet Nam, and Peru have all expressed interest and starting negotiating terms for joining the TPP. In the latest development, just before the APEC Leaders Meeting in Hawaii in November 2011, the number expanded to 12, as first Japan, then Canada, and Mexico all pledged to join the TPP. Suddenly, the TPP could develop into one of the largest free trade zones covering Asia and the Pacific. For the US, the TPP is one of the major vehicles that could help to shape its strategic agenda with the region. For others, the agreement will have provisions allowing these countries to address emerging trade and economic issues as well as those that will arise with the addition of more countries.

Initially, the TPP was seen as a low-key effort with little economic impact on the US. The four core members are small countries, with Singapore and Chile having free-trade pacts with the US. Apart from these countries, Australia, Peru, Malaysia, and Viet Nam are also negotiating

for free-trade pacts with the US. The TPP aims for a high level of trade liberalization—members are required to remove all tariff barriers on all products without exception within 10 years. With so many countries looking to join the TPP, there are questions such as whether these countries could follow suit, and whether the TPP could be the way to achieve the now-stalled APEC Free Trade Area of the Asia–Pacific (FTAAP). Indeed, this latest momentum of the TPP is seen as a way for the US to counter the economic influence of the PRC in the region, and the Government of the United States under President Barack Obama has taken a new interest in region building and its role in East Asia, although the US is not yet a member of the TPP.

In conjunction with the latest development, Japan decided to join such a deal, a move which, Japan said, could improve access to foreign markets and enhance regional trade and investment, even though the government still has to explain to those concerned in the sectors who are citing food security and cultural reasons for protection. The entry of Japan would also undoubtedly complicate future talks within the TPP because of its economy with highly sensitive domestic politics and protected agriculture sector. Despite this, Japan has expressed its keen interest in joining the TPP to spur growth in a country now facing the aftermath of the tsunami and a shrinking population. What Japan did not say is how the strategic interest of Japan might have to be reshaped with regard to Asian regional agreements such as an RCEP, in which Japan is a strong supporter of an ASEAN+6 FTA.

Development of the TPP could directly impact the region building work of the RCEP's future agenda. Certainly it looks like the US will push toward a new framework, possibly in 2012–2013, then work on the legal text of a full agreement soon afterward. By then, ASEAN would like to push for its own RCEP with the support of major countries, in particular the PRC and Japan. It has become clear that Japan feels it needs to figure in both the RCEP as well as the TPP to secure its economic and strategic interests in a broader Asia and the Pacific. The position of the PRC regarding the recent development of the TPP is less obvious, but it is certain that the PRC will maintain its own position with regard to the process of ASEAN+3 or EAFTA. Whether this development represents competition or complements ASEAN's centrality in conducting the RCEP is still an important issue.

ASEAN is not united on this particular development. On one hand, Brunei Darussalam and Singapore are the original members of the TPP, with possibly another two countries of ASEAN (Malaysia and Viet Nam), who are still negotiating their terms, to join the TPP in the near future. On the other hand, a recent policy development requires ASEAN to be more vigilant, thoughtful, and forward-looking for its involvement in the RCEP. If the Philippines looks to join the TPP, that will leave the two most important ASEAN economies—Indonesia and Thailand—which are both also members of APEC, still to take a position on whether to join the TPP. If this does not happen soon, there will be tremendous pressure and demands for a clear position from these two countries, which will require them to respond as well as to clearly determine whether and in what way the TPP could compete with or complement the future development of the RCEP. Eventually, both countries might like to see the beginning of negotiations on an ASEAN–US FTA, which could then allow both sides to play a certain role in determining the future course of trade liberalization.

## **5. ARCHITECTURE OF ASSOCIATION OF SOUTHEAST ASIAN NATIONS FREE-TRADE AGREEMENTS TOWARD 2030**

The emergence of ASEAN FTAs from a timid beginning, particularly from AFTA to the AEC, to become an integration hub for FTAs in Asia is regarded as a very interesting development (Kawai and Wignaraja 2011). This development reflects important changes in the world economy, such as the growth of regional and global production networks. These networks require better regulation and supervision in a range of areas, and consistent FTAs may be

addressing this need. The implementation of an ASEAN FTA hub could bring substantial benefits to ASEAN as a whole as long as it is consistent with ASEAN's own economic integration, although ASEAN might not succeed in building a full hub of FTAs (Petri 2009).

More recently, there has been increasing recognition of ASEAN's role and centrality in driving increasing Asian economic integration. The challenge for ASEAN is to work out a region-wide framework like the parallels of EAFTA and CEPEA, in addition to the countries' bilateral and ASEAN+1 FTAs, to maintain momentum by extending regional economic integration to a group of partners with an appropriate measure of the gains associated with the AEC. At the same time, ASEAN's move to drive integration provisions requires broader and deeper regulation, so they could apply to goods, services, and investment from all countries, not just the members of the preferential agreements.

Given the development of ASEAN FTAs into different paths at different speeds and frameworks, it is interesting to look at a likely landscape that might potentially be the result of future development. If ASEAN FTAs are to be achieved by 2030, what kind of architecture should it have? Fortunately for ASEAN, it has four clearly developed paths—AEC, ASEAN+1 FTAs, country bilateral FTAs, and region-wide FTAs. However, with different paths at different speeds and using different frameworks, ASEAN will continue to evolve along all paths taken.

To help with an overall understanding, further analysis will use time horizons, short and long term, that need to be broadly distinguished. The strategic significance will be indicated as important, very important, and not important. In such a way, one should be able to distinguish the strategic importance related to each path chosen and issues related to it. In addition, essential outcomes for each path chosen by ASEAN are described in further detail below (and Table 9). Finally, whatever the paths chosen by ASEAN, this table is useful to reflect broad policy recommendations of ASEAN FTAs.

**Table 9: Architecture of Association of Southeast Asian Nations Free Trade Agreements toward 2030**

Item	Short-Term Target	Long-Term Target
I. ASEAN Economic Community	Deeper and broader economic integration among ASEAN members and with ASEAN dialogue partners	
A. Single Market and Production Base		
A.1 Free Flow of Goods		
A.1.1 Tariff elimination	Very important: All tariffs for products in the CEPT sensitive and highly sensitive lists of ASEAN-10 eliminated for intra-ASEAN trade	Very important: Complete free trade area
A.1.2 NTM and NTB elimination	Very important: Verification and cross-verification of NTBs among ASEAN member progressing	Very important: Elimination of all NTMs and NTBs for intra-ASEAN trade
A.1.3 Rules of Origin	Very Important: Rules of origin and self-certificate system made more user-friendly and accessible with a low transaction cost	Very important: Easing of “Asian noodle bowl” effect
A.1.4 Trade Facilitation	Very important: High utilization rate of AFTA; harmonization of customs procedures, AFTA green lane, products standard and conformance (identification of TBTs), mutual recognition arrangements	Very important: 100% utilization rate of AFTA
A.2 Free Flow of Services (Mode 3: Commercial presence)	Very important: Rules of origin to identify nationality of the investor	Very important: Elimination of beyond-the-border measures and harmonized domestic rules and regulations
A.3 Free Flow of Skilled Labor (Mode 4: Presence of natural persons)	Very important: MRAs or other agreements agreed to facilitate movement of skilled workers	Very important: Liberalization for national treatment limitations
A.4 Free Flow of Investment	Very important: National treatment granted to investors both at pre-establishment and post-establishment stages	Very important: Comprehensive investment area
A.5 Freer Flow of Capital	Very important: Removal of all capital controls; full financial services liberalization	Very important: Prepare for further economic and monetary integration
B. Competitive Economic Region		
B.1 Competitive Policy	Very important: Competition laws harmonized among ASEAN members	Very important: Implementation of ASEAN competition laws
B.2 Consumer Protection	Very important: Harmonize consumer protection rules and regulations	Very important: ASEAN institution for consumer protection
B.3 Intellectual Property Rights	Very important: Harmonization of laws related to intellectual property rights	Very important: Enforcement at the regional level
B.4 Infrastructure Development and Ratifying Transport Agreements	Interstate transportation without any delay and barriers	Very important: Integrated transportation network
C. Equitable Economic Development		
C.1 Initiative for ASEAN Integration (Work Plan 2)	Very important: Bridging a wide gap among the group of high-income members (Singapore, Malaysia, Thailand), middle-income members (Indonesia, Philippines, Viet Nam), and low-income members (Cambodia, Lao PDR, Myanmar, and Timor-Leste)	Very important: Implement further policy framework to support convergence of economic development
C.2 Studies and Development of ASEAN SMEs	Very important: Remedies to support SME integration	Very important: SMEs network development in the region
D. Integration with the Global Economy		
D.1 Bilateral and Regional Trading Arrangements of Each ASEAN Member	Very important: Ensure each member's bilateral trading arrangements serve whole ASEAN region as a building block, rather than a roadblock, to greater ASEAN economic integration	Important: Consistent with the increasing importance of RCEP

Item	Short-Term Target	Long-Term Target
D.2 ASEAN+1 Agreements	Very important: ASEAN unity required to gain negotiating power with dialogue partners	Important: Consistent with the increasing importance of RCEP
D.3 ASEAN++ FTA	Very important: Ensuring ASEAN centrality, ensuring all ASEAN members act as one with dialogue partner	Very important: Prepare for further regional economic and monetary integration
<b>II. ASEAN+1 Agreements</b>		
AANZFTA, ACFTA, AIFTA, AJCEP, AKFTA		
Trade in Goods	Very important: Consistent with AEC (Rules of Origin and Customs Procedures)	Important : Consistent with AEC
Trade in Services	Important: Ongoing development/partial liberalization	Very important: Ongoing development/nearly complete liberalization
Investment	Important: Ongoing development/partially open to ASEAN dialogue partners	Important: Consistent with the concept of AIA

AANZFTA = ASEAN–Australia–New Zealand Free Trade Agreement; ACFTA = ASEAN–PRC Free Trade Agreement; AEC = ASEAN Economic Community; AFTA = ASEAN Free Trade Agreement; AIA = ASEAN Investment Area; AIFTA = ASEAN–India Free Trade Agreement; AJCEP = ASEAN–Japan Comprehensive Economic Partnership; AKFTA = ASEAN–Korea Free Trade Agreement; CEPT = Common Effective Preferential Tariff; NTBs = Nontariff barriers; NTMs = Nontariff measures; RCEP = Regional Comprehensive Economic Partnership.

Source: Authors' compilation.

**Path 1:** Achievement of the AEC is crucial to ASEAN's FTAs as a whole, as this will lessen the complexity of ASEAN-related trading arrangements and could help strengthen ASEAN's ability to play the Asian integration centrality role. In the long run, up to 2030, completion of the AEC is feasible with regard to free flows of goods, services, and investment, although the AEC might still fall short of its targets beyond 2015 in the areas of rules of origin, non-tariff measures, implementation of goods and services beyond mutual recognition (MRA), and others. It is likely that other targets related to becoming a competitive economic region, equitable economic development, and integration with the global economy will also be achieved quite satisfactorily, while ASEAN will likely be transformed into an interesting entity, building on its strength, and moving further to improve the quality of ASEAN FTAs.

**Path 2:** Although ASEAN+1 FTAs have become an important feature of the way people look at ASEAN as an important hub in Asia, this picture might change in the future, particularly in the longer run. It is possible to see that trade in goods could remain an important path for ASEAN dealing with major trading partners in the short run, but this might dilute its importance when it comes to the long run as ASEAN might prefer to use region-wide FTA(s). This perspective could be part of the proliferation of such FTAs creating the "Asian noodle bowl" effect related to the rules of origin. The same could apply to investment as most ASEAN+1 FTAs could develop in parallel with the ASEAN Comprehensive Investment Agreement (ACIA), with gaps expected for different agreements. However, trade in services might generate stronger interest from ASEAN+1 partners as the issue is of major interest for both sides and they will try to solve impediments related to trade and investment so that a clear picture of service liberalization in the long run might result from negotiations.

**Path 3:** Country participation in bilateral FTAs might slow down somewhat over time, although it is still widespread and transcends regional boundaries. The proliferation of country bilateral FTAs is not being matched by an expansion in trade flows that receive preferential treatment. These FTAs are also complicated by rules of origin, particularly where the costs of compliance are higher than the benefits perceived for firms. Interest from ASEAN firms is expected to reduce sharply over time to almost "not important" for them as the agreements are replaced by other paths of ASEAN FTAs. However, country bilateral FTAs might still be enjoyed in the areas of trade in services and investment, and such targets could be developed in parallel with ASEAN+1 FTAs.



**Path 4:** Creation of the RCEP is an important feature of ASEAN FTAs in the long-term, consistent with completion of the AEC, with the AEC facilitating deeper regional integration and the RCEP aiding broader regional integration. By 2030, the issue of the RCEP should be strengthened, given the fact that ASEAN's centrality will play an increasingly important role in managing this open regionalism. Interestingly, the steps to arriving at the RCEP will benefit ASEAN as the RCEP continues to develop, but it is also important for ASEAN to play an active role in carving out this agreement in terms of its practicality, openness, and leadership. The focus of policymakers should be slowly moving away from various ASEAN+1 FTAs and EAFTA, to CEPEA or even broader regional trading arrangements. It is important to note that the RCEP will serve to consolidate ASEAN's FTAs, particularly reducing the complications related to multiple rules of origin, generated by different paths of ASEAN FTAs. ASEAN's role and interest in making a success of such framework is that implementation will be very important for East Asian economic integration as a whole. For these reasons, a comprehensive and gradual approach will be used in all areas of trade in goods, trade in services, and investment, with success expected to be more in the areas of trade in goods and investment, rather than in trade in services.

It is important for ASEAN to put into perspective the 2030 architecture of ASEAN FTAs, thus including the importance of path 1 in relation to other paths, and in particular the potential of path 4 in helping to consolidate ASEAN FTAs. Setting up the RCEP may take longer, but implementation remains important as this may also be spread over time and in stages. The ASEAN Connectivity Master Plan could also be exploited more broadly to improve the competitiveness of ASEAN and to connect South Asia and East Asia for an eventual integrated pan-Asia.

## 6. CONCLUSION

It has been a long journey for ASEAN's free trade area—AFTA—with a certain level of success among its members, particularly for trade in goods. However, the same cannot be said when it comes to nontariff barriers, which are still in need of being further reduced, and commitments in free trade in the coming years. The same applies to service liberalization—member countries have not been able to develop and liberalize much further. Although there have been some improvements with regard to ASEAN investment areas, these improvements are less advanced than the liberalization for trade in goods.

To find its own version of deeper regional integration, ASEAN realized the need to move toward the AEC by 2015. It would provide a single market and production base, and keep ASEAN competitive and globally oriented. For this to occur, their own version of AFTA has to be further developed into ATIGA to realize the AEC. Such an agreement is much more comprehensive than anything in the past, particularly its extent with regard to nontariff barriers. By 2015, the year of realizing the AEC, a substantial number of nontariff barriers (but not all) are supposed to have been reduced.

For free trade in services, ASEAN still has not been able to do practical groundwork, especially in mode 3 of service supply, because of its lack of rules of origin in the services sector. To allow ASEAN investors to own a 50% or more share in services companies, a proof of substantive business operation are required. These substantive business operation rules are designed to ensure the scope of liberalization is limited to ASEAN investors only, not the ASEAN nominees of the extra-ASEAN business firms.

At this stage of liberalization, with the objective of moving itself closer to real free trade area, ASEAN+1 and countries' bilateral FTAs have a greater chance of improving in the negotiations among members. However, ASEAN+1 and bilateral FTAs will decrease in importance in ASEAN as the region moves closer to 2030. The main reason for their loss of importance in policymaking is directly related to development of the RCEP to work in tandem with a broader framework of the World Trade Organization, which is also helping and

supporting the multilateral framework in a complementary way. The only rationale that remains for ASEAN+1 and bilateral FTAs is for ASEAN to gain the status of a regional hub, or play its centrality among more trading partners, in addition to the remaining countries' interest in bilateral deals, which might still be the order of the day.

The RCEP has to be implemented sooner rather than later as it directly corresponds with development of regional production networks in which ASEAN and major economies have become increasingly linked. Accordingly, for ASEAN, the more members the grouping has with other countries, the more benefits the members will gain. From observations by many other economists (e.g., Urata and Petri), it is evident that the more open the grouping, the more the members will get from the hub of ASEAN, which could also be developed to becoming an Asia-wide region, which would have more benefits than losses. Ultimately, the RCEP could favor economic growth and industrial development, making country members both competitive and cooperative. However, there should be a pathway to help narrow the development gaps and social inequality which still exist in the region and are of particular concern to the lesser-developed countries such as Cambodia, Lao PDR, and Myanmar.

The following are the major challenges for ASEAN in realizing the AEC 2015:

1. Complexity related to the rules of origin will only worsen the "Asian noodle bowl" effects. For this reason, it is important for ASEAN policymakers to reduce such an impact while making any future FTA commitments.
2. Reduction of nontariff barriers is crucial for ASEAN, which needs all members to commit to such a process and to proceed efficiently.
3. Taking a soft approach to trade facilitation among its members, ASEAN standards and technical regulations need to be set in accordance with each ASEAN member's domestic practices but also have to be consistent with recognized international industrial standards.
4. Gaps that remain among major players in ASEAN exist at both the public and private level. A better understanding is needed among the 10 ASEAN member countries that each government needs stronger political will to play a much more active role in working in a more consensus-driven way at the domestic level. The role of the private sector is also important in advancing the realization of the AEC, which is still to find the respective roles for both small and medium-sized enterprises and multinational companies.

A fundamental transformation is finally underway for the future of ASEAN's deepening and widening economic integration. To start with, the realization of the AEC by 2015 is very important. However, these tasks will not be completed by then as it will require more commitment from all ASEAN members including Cambodia, Lao PDR, Myanmar, and Viet Nam. The deepening process will continue, perhaps with a further implementation of the phase 2 blueprint—a new version which could reduce loopholes and gaps among its members, in particular countries' trade liberalization and its links to the ASEAN institutions which need to be strengthened.

With the advent of the RCEP, the broadening process is also becoming more crucial to ensure ASEAN centrality. While all members will be busy implementing such an agreement, the scope and extent of the agreement will be in direct competition with bilateral and regional trading arrangements of each ASEAN member and ASEAN+1 agreement. However, with a proper policy framework, the RCEP will emerge more strongly Asia-wide in the longer run as the agreement is suppose to be more practical and workable, with an aim to reduce the noodle bowl effect to increase the chance of success by 2030.

Certainly the RCEP must implement trade liberalization consistent with what will be done under the scope of the AEC and consolidation of the rules of origin resulting from overlapping FTAs. Trade in services, however, is still a difficult area for participating

countries with different levels of development, so it needs to find its own path for development in the short run, with a clear strategy for its trade liberalization to be found in the long run. Investment issues could be developed in parallel with the ASEAN+1 process in the short run, but will become more important in the longer run as development into a comprehensive investment area should involve greater efforts and commitments from participating countries. Finally, ASEAN should not let the ASEAN++ FTA be undermined by development of the TPP, which seems to be a parallel development, at least in the short run, and despite the participation of several ASEAN members in such an agreement.

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