

## APPENDIX II

### *Is ASEAN Still Relevant? Some Thoughts from a European Perspective*

---

ROLF J. LANGHAMMER

#### **Changing Institutional Underpinnings in Globalizing Goods and Capital Markets by the Turn of the Century: What Is Exogenous for ASEAN at the External Frontier?**

While the number of World Trade Organization (WTO) contracting parties is rising, the number of relevant actors in the world trading order is shrinking. Big players like the United States and the European Union (EU) increasingly act as catalysts for neighbouring countries which harmonize their national trade policies with those of the players. Most countries pursue harmonization via free trade areas (Mexico, Israel, Norway, Switzerland), very few (Turkey) have already gone further by forming a customs union with these players. Other smaller players intend to first implement a customs union among themselves before linking their union to the big players' trade policy via a regional free trade agreement (such as relations between the Mercado Comun del Cono Sur [MERCOSUR] and the EU). Each of the three paths will lead to economies of scale in trade policies. At the very end, few trading blocs (defined as customs unions) will decide on the outcome of multilateral negotiations, which in fact are already oligopolistic negotiations.

The “open regionalism” style of APEC has not (yet) delivered convincing results in stimulating global liberalization from bottom-up. It needs success stories soon, otherwise it will lose to the traditional preferential EU style of regionalism pursued by the majority of emerging economies in Latin America and Europe, as well as by the ASEAN Free Trade Area (AFTA).

Parallel to the declining number of trade policy actors, the number of relevant currencies traded in the financial markets will also decline. This is not only due to the European Monetary Union but also to the lessons from the Asian economic crisis. These lessons suggest that exchange rate regimes which do not seem sustainable will be tested. Such tests speak against in-between-exchange rate regimes, such as different exchange rate crawls. Thus, the two polar cases (either fixing exchange rates completely [currency boards] or full floating) are credible alternatives. Many small economies with both strong trade and capital links to a major player will take the first (admittedly dangerous) option into more serious consideration than in the past.

In many cases, regional trading blocs and regional currency blocs will have overlapping membership, thus reinforcing each other (Mexico with respect to the United States, and Eastern Europe with respect to the EU). The larger the overlap, the stronger is the position of the anchor currency (in the capital account) and the anchor country (in the current account of the smaller economies), respectively.

Where does ASEAN find its niche if the two scenarios materialize? Its position is difficult for two reasons. First, unlike Europe and Latin America, currency blocs and trading blocs do not overlap in ASEAN (and Asia), and secondly, there is no dominant economy in ASEAN or in neighbouring Asia playing the role of the anchor country or anchor currency.

### **The State of ASEAN Economies in 1999: What is Exogenous for ASEAN at the Internal Frontier?**

Seen from Europe, divergences with ASEAN seem to have grown from different angles. To start with the least controversial one, membership has been extended to the low-income Indochinese economies which are rudimentary with respect to market economic principles and which have been given longer adjustment periods to meet AFTA commitments than the other AFTA members. The EU

pattern of concentric circles around a core group comes to mind, but unfortunately divergences have also grown among the ASEAN founding member states. Given the political foundations of ASEAN, political divergences seem to be more relevant than economic disparities in terms of (temporarily) widening growth gaps. Political divergences, for instance, comprise dissenting views on more or less use of controls in transborder trade and capital transactions or on pros and cons of getting involved in partner countries' internal issues. Such dissenting views can strongly impede common targets, such as the implementation of AFTA, or of an ASEAN free investment zone, or extending free trade agreements to neighbouring non-ASEAN members.

The Asian economic crisis has supported views that ASEAN as an actor in international politics owed its reputation primarily to past non-economic achievements than to present economic achievements. Its reputation would be at risk if internal political controversies are aggravated further and if each member state sees domestic and regional stabilization as trade-offs. The implementation of AFTA would be endangered too. This could become a vicious circle since postponing the AFTA liberalization timetable would further fuel sceptical views on the "economic teeth" of ASEAN.

With political uncertainties in the largest ASEAN member state as a heavy burden, ASEAN (again seen from Europe!) can regain its reputation rapidly if it actively contributes (directly or indirectly) to solving (or easing) its partner countries' internal problems first. There is no substitution process between "external collective bargaining power" and "internal trouble solving". Speaking with one voice to dialogue partners is non-credible if internal trouble-solving fails.

Markets need a convincing signal that the implementation of AFTA and other "binding" commitments to ASEAN-wide liberalization (including investment) are beyond any doubt, whatever happens internally. Europeans would fix such commitments in a treaty. How does the ASEAN way of "tying hands" solve this?

### **ASEAN Integration and Co-operation Widening and Deepening: Two Substitutable Options?**

The Asian economic crisis of 1997–98, which clearly demonstrated current account transactions being wiped out in importance by capital account transactions, seems to have induced ASEAN to

consider areas of co-operation besides trade. An ASEAN investment area is one such area, which is not necessarily new, given previous endeavours — for example, the Individual Action Plans (AIP), the ASEAN Industrial Complementations schemes (AICs), and the ASEAN Industrial Joint Ventures (AIJVs). Areas with cross-border spillovers, such as the environment, can be added to this list.

Apart from an issue-related widening of ASEAN integration and co-operation, a country-related widening of integration is under way, covering the Indochinese economies first, but ultimately the Australia–New Zealand area too.

The experience of Europe, the only integration area with a simultaneous process of widening and deepening, suggests that deepening and widening are sequences but not substitutable options. Before widening the country coverage as well as the issues, an integration area needs a solid core area with a good record of liberalization achievements. This is what is called the *acquis communautaire* in the EU. For ASEAN, the core group comprises the founding member states, and the issue is the free trade area. Hence, completing the AFTA programme is of utmost importance for the core group to maintain credibility. To be consistent with the WTO, AFTA should lower and/or bind external tariffs to internal tariff dismantling. The next step of free investment could be done by establishing general principles of investment in the national investment codes of the member countries. Free investment (that is, the freedom of establishment and free mobility of investment-related labour), however, seems to be a more distant target. Under the current conditions, this target seems overly ambitious, particularly seen against the background of member countries with different policies regarding the control of cross-border capital transactions.

### **Is ASEAN Relevant?**

By world standards, and measured in terms of gross domestic product (GDP) (not population), AFTA is a mini-integration scheme still in the making. So is ASEAN as a co-operation scheme. Outside Asia, the trend points towards mega-schemes even if it will take time to implement them. If the term “mega” cannot be equated with “efficient”, the specific advantage of large schemes should not be under-estimated. Larger schemes benefit from the existence of stable

core countries, either in institutional or in economic terms. Such countries, being often the largest beneficiaries of the schemes, are the relevant engines for both deepening integration and co-operation, and compensating periphery members for short-term adjustment costs. What is important is that they are accepted by other members to act as engines and mediators. Such core countries which are able and accepted as engines to deepen integration and to shoulder burdens for other members are today difficult to identify within ASEAN. If “relevant” is equated with “promising”, there is doubt whether ASEAN is relevant.

Today, purely trade-oriented free trade areas are considered standard and do not draw much attention from potential investors. Schemes which are more ambitious and may leave an impact on financial markets are at least customs unions, including free mobility of capital. For economies oriented to the world market and exporting a large part of their international supply to non-member countries (as in the ASEAN case), internal liberalization is less important than external liberalization. However, even if it is true that internal liberalization can improve the collective bargaining power in external trade negotiations, the ASEAN member countries stand to lose if they use too much resources on liberalization within a mini-scheme. There are opportunity costs if skilled international negotiators are in short supply and if an increasing number of trade issues like e-commerce spreads beyond regional boundaries.

ASEAN is a white sheet of paper in financial market integration. There is no ASEAN-wide bond market, no common position in handling international capital transactions, no common peg or common exchange rate basket, no common standards for the accounting sector, no common position towards the Basle standards for capital adequacy, no common prudential standards, not to speak of a common currency. In financial market integration, including banking supervision and prudential standards, ASEAN as an entity does not exist. Thus, the ASEAN-10 is more heterogeneous than ever. Should markets see overlaps between the direction of trade and capital flows as a promising indicator (and therefore relevant to deep integration), then again ASEAN is not relevant.

Given all these (admittedly) intuitive remarks, I conclude that ASEAN's pre-crisis reputation was considerably larger than its reputation today and that its relevance (in terms of potential gains for the economies) has declined. This is not only due to the financial

crisis, which was outside the realm of ASEAN, but also due to its incapability to handle typical internal co-operation issues efficiently (such as the haze issue).

In spite of the sceptical view raised above, I conclude with an optimistic forward-looking note, which, however, is bound to conditions. To reappear as an internationally recognized actor, ASEAN must implement AFTA on time in order to demonstrate credibility and bad-weather quality, not because AFTA is critical to economic recovery. Simultaneously, external liberalization should be announced and bound with the WTO to meet Article 24 of the GATT (General Agreement on Tariffs and Trade) requirements. ASEAN should not go the easy way through notification under the "free-rider" Enabling Clause of 1979 (special and differential treatment). Secondly, negotiating and implementing ASEAN-wide minimum standards for prudential regulations and banking supervision in the financial sector of the founding member states would be helpful to signal the entry of ASEAN into the capital account sphere. Thirdly, anchoring the most-favoured-nation (MFN) scheme and national treatment as ASEAN-specific elements in all national investment regulations would qualify ASEAN as a player in the forthcoming negotiations on trade and investment in the WTO. Finally, to overcome the disadvantage of being small, ASEAN should initiate an ASEAN-OCEANIA economic partnership focusing on trade and investment facilitation, as well as issues with cross-border spillovers, such as environmental protection, cross-border crime control, meteorological research, natural disaster prevention, and emergency relief.

However, it goes without saying that the success of the latter proposal in particular, and of the entire ASEAN rehabilitation programme in general, is inseparably linked to political stabilization and economic recovery in Indonesia.