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# ASEAN Roundtable: 25 Years of ASEAN AFTA: The Way Ahead Singapore, 3–5 September 1992

## SUMMARY RECORD

THE ASEAN Free Trade Area (AFTA) was agreed upon at the Fourth ASEAN Summit in January 1992, in Singapore. The formation of AFTA reflects both developments within ASEAN and the changing international economic and political environment. Internally, rapid industrialization in all the ASEAN countries has given rise to greater intra-ASEAN trade, particularly in manufactured products. Trade has also become more complementary than competitive amongst the ASEAN countries. Externally, the changes wrought in the international sphere have exerted pressure on ASEAN to strengthen its co-operation in the economic arena. The emergence of regional blocs such as the Single European Market (SEM) and the recently concluded North American Free Trade Agreement (NAFTA) have also had a major impact on ASEAN's perceptions of the global trading system. Fears of trade and investment diversion, coupled with increasing competition for foreign direct investment, have forced ASEAN to forge closer economic ties amongst its members.

Accordingly, this year's ASEAN Roundtable, "AFTA: The Way Ahead", focused on the recent steps to create a free trade area. Discussions centred on the following areas:

1. Rules of Origin and Content
2. Rules of Competition and Tariff Reduction
3. Exclusion Lists and Safeguard Measures
4. Dispute Settlement
5. AFTA-Plus
6. The Role of the Private Sector

### 1. Rules of Origin and Content

The Common Effective Preferential Tariff (CEPT) Scheme, which is the instrument for implementing AFTA, specifies an ASEAN content requirement of 40 per cent. This is considered to be a reasonable fraction when compared to other FTAs. However, increasing internationalization of production makes it difficult to determine the origin of a product. Furthermore, it is equally difficult to measure the component parts of each item for local content. Thus, enforcing the local content rules would require extensive documentation and increase the overall transaction costs which may then reduce the benefits of freer internal trade. There must, therefore, be caution in the way in which rules of origin are drafted and implemented. The experience of other FTAs can be used to minimize trade disruption due to rules of origin. The European Free Trade Association (EFTA) countries have used a combination of the *Basic*

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*Materials List and Process of Substantial Transformation.* This approach seemed to be agreeable to most of the participants although they suggested some modifications.

Some controversy was generated over whether the CEPT should specify a 40 per cent *national* or *ASEAN cumulative* content. While it would be more simple to administer the national content rather than the cumulative content rule, it would have less trade expansion effects. A cumulative content rule would promote greater division of labour and enhance intra-ASEAN trade but may induce higher imports than the envisaged 60 per cent limit. In general, it was felt that the cumulative content rule would be the best alternative. ASEAN must therefore design and agree on a precise formula for domestic content requirement using the cumulative content rule if intra-ASEAN trade is to be improved.

## **2. Rules of Competition and Tariff Reduction**

The CEPT scheme requires ASEAN member countries to reduce internal tariffs to 20 per cent (or less) within the agreed time frame of five to eight years. While the concept is sound, the agreement is vague on how to phase out tariffs which are already less than 20 per cent. This lack of guidelines gives those low tariff countries with items at less than 20 per cent tariffs a grace period of five or eight years before reducing them to 5 per cent or zero. On the other hand, high tariff countries will not enjoy concessions on a product until their tariff drops to 20 per cent. There is, therefore, discrimination against high-tariff countries and uncertain treatment for low-tariff ones. Participants were conscious of the need for clearer tariff-reduction guidelines so that arbitrary interpretations are avoided in implementation. Similarly, there has to be a clearer definition of "accelerated reductions" in the fifteen broad product groupings under the CEPT Scheme. There is need to agree on what "accelerated" means and to evaluate the options available.

The rules of competition have likewise to be spelt out clearly so that unfair competition can be stemmed. These unfair measures encompass duties and drawbacks on duties on imported inputs; government support schemes such as tax credits and subsidies; procurement procedures; treatment of revenue tariffs; and dumping. Rules will be needed for each of these areas if competition is to be fair and transparent.

## **3. Exclusion Lists and Safeguard Measures**

The earlier Preferential Trading Arrangements (PTA) suffered from the existence of exclusion lists which kept out many items which were of interest in intra-ASEAN trade. In order to avoid a similar fate, AFTA enumerated fifteen product groups for immediate consideration and a revamped exclusion list. The inclusion list assumes that all items are included in the AFTA and is based on the six-digit harmonized standard (HS) code. This is a considerable improvement over the PTA as six-digit items are well-defined. However, the new exclusion list is specified at the eight and nine-digit HS codes. Hence, there will be difficulty in comparing exclusion lists amongst the different countries, even though the exclusion lists are to be temporary.

A further problem is that exclusion lists are to be reviewed in eight years, which is far too long a period. ASEAN may, therefore, have to generate a common eight- and nine-digit classification so that all items are comparable. Participants called for every effort to minimise the number of items on exclusion lists.

Emergency measures are also needed to protect firms from injury caused by massive flows of imports as well as to enable firms to make the necessary adjustments. These emergency safeguards, as specified in the AFTA agreement, do not provide specific timetables for phasing them out. The emergency measures must be limited and phased out in order to force industries to improve their efficiencies in a gradual manner. In addition, it was observed that industrial co-operation should be expanded and linked more

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closely with trade co-operation. The vagueness of the linkages between trade and industrial co-operation as they are currently constituted under AFTA leave much to be desired.

#### **4. Dispute Settlement**

The implementation of AFTA will, no doubt, engender disagreements on the interpretation of rules and regulations. As the ASEAN approach has been consultative and less amenable to a legalistic framework, it must now consider setting up a formal dispute settlement procedure. This has to be transparent so that the obligations of participating members are clear. However, there was a concern as to whether ASEAN could develop an alternative to the legalistic approach or of judicial review so that credibility could be maintained in the eyes of the private sector.

#### **5. AFTA-Plus**

Probably the single most important factor will be the extent to which ASEAN countries recognize that a successful free trade area requires going beyond the traditional definition of a free trade area, since numerous experiences have proven that cutting tariffs alone is not effective. AFTA should go beyond an FTA to include non-border issues of economic co-operation and integration, creating "AFTA-Plus". These points were well-received by participants and agreed upon.

AFTA-Plus should then pay attention to such issues as trade-related investment policies; product standards and other technical barriers; and trade-related intellectual property rights, including patents, copyrights, and trade marks. This would align ASEAN co-operation efforts with multilateral integration under GATT, which is also dealing with these issues at the Uruguay Round.

#### **6. The Role of the Private Sector**

There was wide agreement that the successful implementation of AFTA will require the co-operation of government and the private sector. However, the Roundtable noted that the views of the ASEAN private sector on the implementation of AFTA indicate some concerns of possible obstacles or difficulties to the fruition of AFTA arising from:

(a) *Lack of information*: It was reported that manufacturers and trading firms who would be directly affected by changes in tariffs were not adequately or effectively knowledgeable of the various details of the CEPT scheme which were worked out by government officials. Recent lobbying for protection in affected industries in member countries, particularly Thailand and Malaysia, did create a sense of uncertainty of the credibility of the AFTA commitment.

(b) *Non-tariff barriers (NTBs)*: These were highlighted as the most notable and worrisome hindrance to the desired trade expansion and trade-related investment commitments in ASEAN. Such NTBs include customs classification and procedures, subsidy schemes for domestic producers and purchasers, testing procedures, local content rules, and health and safety standards. The majority of these NTBs fall under the UNCTAD Type II NTB category — which are measures not directly associated with commercial policy, but intentionally used to restrict imports or promote exports. Inefficient customs practices, arduous bureaucratic procedures and even attempts at "rent-seeking" activities and other such impediments effectively discouraged many manufacturers and exporters from contributing to the growth of intra-ASEAN trade. Further constriction of trade flows could arise from Type I NTBs, including, licensing requirements and monopolistic privileges of public enterprises.

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(c) *Domestic regulations that were reported to exert negative effects* upon firms interested in diversifying/expanding their exports to other ASEAN countries. These include local investment laws and regulations, seemingly protective of the interests of certain local industries, which prevent the use of one country as a base from which to service another. {The “ASEAN-X” government restrictions, for instance, do not facilitate the use of industrial zones in “ASEAN-X” country as a base to serve markets in “ASEAN-Y”). Industries which are export-oriented are required to use bonded warehousing, and the bureaucratic procedures for movement of goods and components are so cumbersome that business becomes unattractive. Such distortions from liberal trade and investment policies need to be corrected to enhance intra-ASEAN trade flows.

(d) *Subsidy Schemes* in some “sensitive” or “essential” sectors have caused significant distortions in market prices so much so that entry of other ASEAN producers has been disrupted. For instance, in an “ASEAN-Z” country, fertilizers are subsidised heavily by the government irrespective of size of the buyer (although there may be instances when consideration of type of the user become more important than size of the buyer). Consequently, the more sophisticated manufacturers in other ASEAN countries find it cheaper to buy in that country’s market than to produce elsewhere and sell there. This example illustrates that the spillover effects of income and industrial policies may have an adverse impact on trade.

The above concerns of the private sector need to be seriously addressed and appropriate actions taken. Some participants indicated convincingly that the government officials are open to feedback from the private sector. After all it is the manufacturers and the traders who ultimately commit themselves to building plants and equipment to supply the consumers in the ASEAN countries with the desired goods and services. Undoubtedly, on the government side, there is serious intention to implement the provisions for the realization of AFTA, firmly committed in the Singapore Declaration. However, it is recognized that in the process of implementation, various problems concerning tariff, non-tariff barriers, local content requirements, product selection and so forth, can be improved to enhance mutual benefits and economic welfare for as many parties as possible. Thus, the ASEAN ethos — of pragmatism, flexibility and goodwill — enables the government and the private sector of member countries to work together fruitfully.

To conclude, there are many technical matters requiring attention, immediate or otherwise. These problems are solvable and the ASEAN working committees have been meeting to accomplish these tasks, although veiled from the public eye. It is also time for various expert groups to help especially in conducting in-depth research and generating new ideas so that the various problems and matters concerning the effective implementation of AFTA as discussed above can be overcome and resolved. There was even a suggestion by one participant to form a strategic alliance amongst the different circles — government, private sector, academia and the media — so as to ensure the right policy decisions.

In the meantime, it was the general consensus amongst the Roundtable participants that the agreement to establish AFTA is, indeed, a great leap forward, not only in economic terms but much more importantly, in psychological and political terms.

SOURCE: ASEAN Economic Research Unit, Institute of Southeast Asian Studies (ISEAS), Singapore. The ASEAN Roundtable, a closed-door meeting, was convened by ISEAS. It was attended by about 40 senior academics and high-level public- and private-level representatives from within and outside ASEAN.