

# ISSUES



PECC INTERNATIONAL SECRETARIAT

PACIFIC ECONOMIC COOPERATION COUNCIL



4 Nassim Road Singapore 258372  
Tel: 65-6737 9823 Fax: 65-6737 9824  
Email: [peccsec@pacific.net.sg](mailto:peccsec@pacific.net.sg)  
Home page: <http://www.pecc.net>



## Asean Perspectives on Preferential Trading Arrangements

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#### **About this Issue**

This **ISSUES@PECC** was a paper presented at the The PECC Trade Forum and the APEC Study Center Consortium joint session on the 25th May 2003 focusing on the new RTA development in the Asia-Pacific region, and ways in which these RTAs might develop so as to support APEC objectives and the multilateral trading system.

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The author of this paper is:

#### **Dr Hadi Soesastro**

Executive Director, Centre for Strategic and International Studies, Jakarta

#### ***Editorial Committee:***

Prof Robert Scollay  
Coordinator, Trade Forum

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## **Moving on Multiple Fronts?**

Current world trade situation is to a large degree characterized by trade policy initiatives that are simultaneously being pursued at the global, regional and bilateral levels. A number of governments have adopted a trade policy that moves on multiple fronts.

This is best exemplified by the US strategy of competitive liberalization, in which global, regional and bilateral trade negotiations are seen as complementing and reinforcing each other. With the passage of the Trade Promotion Act 2002, which gives the US Administration fast track authority, the US is in the position to pursue what USTR Representative Robert Zoellick called “free trade on the offensive”. On the global front, the US has proposed a bold initiative to push multilateral negotiations on the Doha Development Agenda (DDA). This initiative includes significant removal of agricultural subsidies, substantial reduction of agricultural tariffs, zero tariffs on consumer and industrial goods by 2015, zero-for-zero sectoral liberalization as well as liberalization of key services sectors.

On the regional front, the US is pursuing the FTAA (Free Trade Area of the Americas). It has launched the EAI (Enterprise for ASEAN Initiative) and a similar initiative for the Middle East. On the bilateral front, it has recently signed a FTA (free trade agreement) with

Singapore, the first with an Asian country, and has concluded one with Chile. It has begun negotiations with Australia and is also engaged with Morocco, CAFTA (Central American Free Trade Area) and SACU (Southern African Customs Union) in bilateral negotiations.

As argued by Feinberg (2003), the US is not the leader in the global rush towards bilateral and regional free trade agreements, rather it is only playing catch-up with the rest of the world. It should be noted that in the late 1980s a similar policy of moving on multiple fronts was also developed by USTR Representative William Brock, producing the US-Israel FTA and a US-ASEAN Initiative (UAI) that never took off.

In Bergsten’s view, the US remains “the pivotal operator” in the global trading arena. Through its regional and bilateral trade deals the US intends to put pressure on non-members of individual trade agreements either to join the group itself or to conclude broader agreement. The objective is to accelerate their liberalization in ever-widening circles until global free trade is achieved. Its “free trade on the offensive” policy is also, if not mainly, directed towards the European Union (EU). The EU’s actions will also be decisive in determining the outcome of global trade negotiations. It is the view of the US that Europe badly needs outside pressure to implement internal reforms, especially in agriculture,



and that such outside pressure can come primarily from the US (Bergsten, 2002).

It cannot be denied that bilateral preferential trading arrangements (PTAs), including free trade agreements (FTAs) can be used as an important foreign policy instrument. Indeed, most PTAs involving East Asian economies today are essentially politically motivated. It also needs to be noted that the use of bilateral PTAs as an instrument to promote global free trade can have political implications due to the “selectivity” with which this instrument may be used. The EAI as well as Japan’s bilateral FTAs with ASEAN will be practically limited to a subset of ASEAN members. The newer members of ASEAN are likely to be left out because they simply cannot take part in it. This can have serious repercussions for ASEAN’s cohesion.

Since many of the proposed PTAs involve APEC members, can APEC provide some guiding principles that help ensure that these initiatives will indeed lead to global free trade?

### **PTAs in East Asia**

In East Asia there is a surge of initiatives to form bilateral and sub-regional PTAs. The list of such initiatives is rather impressive. However, in the four years since the first initiative was launched with the proposal for a Japan-Korea FTA, only a few have been actually concluded

amongst East Asian countries, namely the Japan-Singapore Economic Partnership Agreement (JSEPA) and the ASEAN-China Comprehensive Economic Cooperation Framework Agreement. Singapore has also concluded bilateral FTAs with the US and Australia, and Korea has concluded one with Chile.

Since concluding a framework agreement with China, which has a FTA component, ASEAN has been courted by other trading partners. A framework agreement is being negotiated with Japan to be concluded before the end of 2003. India has made a similar proposal and so has The US, through Bush’s EAI (Enterprise for the ASEAN Initiative) proposed bilateral FTAs with selected ASEAN countries. Having been drawn into the game as well, the challenge to ASEAN as a group is to consolidate the various initiatives that it and its members are engaged in so as to be able to promote region-wide and global trade liberalization. In the East Asian context today, ASEAN has a specific role to play and to carve out for itself in promoting the development of an East Asian Economic Community through trade cooperation and liberalization.

FTAs in East Asia are essentially politically driven. However, politics alone cannot bring about a successfully negotiated outcome. The Japan-Korea FTA proposal was meant to cement a political relationship that greatly improved in the late 1990s. However, it

did not come off the ground because the economic benefits from the FTA were perceived to be too asymmetrical to the Koreans. The Japan-Singapore agreement (JSEPA), signed in January 2002, can be regarded as politically driven as well. In the context of Southeast Asia's development post-crisis, Singapore sees the need to differentiate itself from the rest and to remain in the radar screen of its major trading partners by going into bilateral FTAs. Negotiations with New Zealand provided a training ground. Japan was next, as Japan was looking for a partner with which it can conclude an agreement. Singapore has virtually no agricultural sector and provided a suitable training ground for Japan.

JSEPA has been advertised as a "new age" partnership agreement, some kind of "state-of-the-art" agreement that goes beyond the WTO agenda. It is perhaps still too early to assess the impact of JSEPA that entered into force on 30 November 2002. First, there will be some tariff savings from the agreement, which according to the Singapore Ministry of Trade and Industry (MTI) would amount to S\$ 60m per year immediately and S\$ 330m per year within 5 years. This is presently the main quantifiable benefit. The business community in Singapore remains unclear about the rules of origin (RoO) that are applied. Second, the agreement provides legal guarantee of services and investment rules. Under the agreement both Singapore and Japan are legally bound to their services and

investment commitments. But the commitments in services and investment in the agreement essentially bind existing status quo. No commitments were made to further liberalize existing regimes and many sectors remain unbound. Third, the agreement on investment protection rules provides for an investor-state dispute resolution mechanism to protect Japanese and Singaporean investors. However, this may not be significant as Japan and Singapore are generally seen as stable investment environments. Fourth, the agreement also promotes economic cooperation on various functional levels between Singapore and Japanese government agencies. However, they are not legally binding. Fifth, the agreement provides "signals to market", namely as a signal for Japanese and Singaporean businesses to move into each other's markets.

It is also premature to assess the benefits of the Singapore-Australia Free Trade Agreement (SAFTA). The gains from FTAs with Singapore are mainly in the non-goods trade sectors. Trade in goods, i.e. tariff elimination, is also a less significant element in US-Singapore Free Trade Agreement. Singapore is to apply zero tariffs immediately on all US products. US tariffs on 92 percent of Singaporean goods are also to be eliminated immediately with remaining tariffs phased out over eight years. Singapore also agreed to allow the importation of chewing gum (banned since 1992) from the US with therapeutic



value for sale and supply subject to laws and regulations relating to health products. The RoO provision in the agreement stipulates that only exports with substantial transformation and value added done in Singapore can be conferred “Singapore origin” and qualify for the FTA tariff rates. A major controversy in the US itself is with regard to the rules of origin in textile and garments and the issue of whether they might become a precedent for other trade agreements. Singapore is not a major trading partner in the textile and apparel sector. The yarn forward rule of origin requires that products be made from US and/or Singaporean originating yarn, with limited exceptions. For imports into the US, all other assembly processes must be carried out in Singapore.

The US-Singapore FTA also provides for imported inputs used in the manufacture of the final products within Singapore to be classified under a different tariff classification from the final product. For some electronic products, the origin is Singapore if a certain percentage of the value added (typically 35 to 60 percent) is done in Singapore. An interesting provision in the FTA is the Integrated Sourcing Initiative that applies to components produced in non-sensitive, globalized sectors, particularly IT and certain medical devices, on which both countries do not impose tariffs. These components, including about 100 IT products, produced by Singapore neighbors will be treated as being of

Singapore origin when they are used in the manufacture of final products in Singapore.

Trade in services is the main component of the FTA between Singapore and the US. The FTA is to accord substantial market access across each other’s entire services sector, subject to a “negative list”. The negative list deals with sectors that usually require government certification or licenses (lawyers, accountants), involve governmental institutions (airports, provision of social security, public hospitals, government corporations), or involve national policy (atomic energy). The other components of the agreement are: e-commerce and digital products; investment, intellectual property rights; competition policy; government procurement; customs procedures (regarded as “ground breaking”); temporary entry of personnel; labor and environmental provisions; and dispute settlement.

The US side does not expect any significant economic effects of the agreement with Singapore because of the relative small size of the Singapore economy. Some see the agreement mainly as providing a standard for FTAs with other countries. In terms of US security interests, the FTA would add a formal economic link to the security relationship with Singapore, and perhaps with Southeast Asia as a whole.

Singapore has been in the forefront amongst ASEAN economies in the FTA game. The direct effects of its bilateral FTAs may not be significant for the other ASEAN countries. It is also obvious that Singapore's FTAs do not lend themselves readily for adoption by other ASEAN countries. However, this should not mean that other ASEAN members should be indifferent to Singapore's undertakings. Singapore may be given the role by ASEAN as the first mover, to use the FTA to strategically engage major economic partners in the Southeast Asian region as a whole. However, being given such a role implies that Singapore should fully consult and brief other ASEAN countries on the process and progress of its FTA negotiations.

A more consolidated, coordinated process in and by ASEAN, including in the development of a common external policy, is an important element of an ASEAN Economic Community, which is already firmly placed in the ASEAN agenda. ASEAN must have a strategy to engage in PTAs as a group. The Framework Agreement on Comprehensive Economic Cooperation between ASEAN and the People's Republic of China (the ASEAN-China CEC) aims at the establishment of an ASEAN-China FTA within 10 years. It is the first for ASEAN (as a group) and is also the first for China. The process leading to the signing of the agreement has been relatively short and swift. This

has surprised many observers, including within ASEAN itself. But the agreement is essentially a framework agreement with many of its components still to be negotiated further. Negotiating the FTA has commenced and is to be concluded by 30 June 2004. The negotiations, conducted by the ASEAN-China Trade Negotiation Committee, will produce schedules for tariff reduction and elimination over a period from 1 January 2005 to 2010 for ASEAN 6 and China, and from 1 January 2005 to 2015 for the newer ASEAN members. This is a rather ambitious goal.

Implementing the agreement will be a major challenge for ASEAN and China. The negotiations may turn out to be more difficult and time consuming than anticipated. However, both sides should recognize that it would not be desirable to conclude the negotiations in big haste only to produce a "dirty" FTA, namely an FTA with many exceptions. Indeed, the ASEAN-China FTA does not intend to use WTO's enabling clause. The process of negotiations itself will be as important to the relationship as the outcome. From ASEAN's perspective it will force the group as a whole to have a constructive engagement with China. Therefore, it was a strategic decision of the part of ASEAN to broaden the basis for the engagement from a narrowly focused FTA, as originally proposed by China, into a comprehensive economic cooperation package. To have framed the relationship within an FTA framework



would be very risky since trading relations between ASEAN and China are bound to be highly contentious. Although the ASEAN-China agreement is essentially politically motivated, this is no justification for producing a “dirty” FTA.

Since the agreement is a “comprehensive” one, it should be given attention to at the highest levels of government. This will ensure that the negotiations will not get bogged down. There are speculations that the FTA component of the agreement will practically be negotiated bilaterally. It should be noted, however, that the framework helps ensure that the negotiation will be conducted in an ASEAN-China forum, and that the rules and principles will be commonly agreed upon by ASEAN. Individual ASEAN countries can come up with its tariff reduction schedules. Unfortunately, some ASEAN members have other ideas. Thailand has proposed to start bilateral negotiations with China. This could weaken ASEAN’s ability to play a major role in facilitating the building of an East Asian Economic Community. More importantly, it threatens ASEAN cohesion and credibility.

With its two-prong approach of negotiating an ASEAN-Japan framework agreement and negotiating bilateral FTAs with selective ASEAN members, Japan is threatening ASEAN’s cohesion and credibility. India too is proposing a FTA with ASEAN but is willing to embark on

negotiating a bilateral agreement with each ASEAN country. Only the EU has consistently insisted on dealing with ASEAN as a group at the advice of European companies that are not interested in a fragmentation of the ASEAN market. Korea should also be advised not to go into bilateral FTAs with selective ASEAN countries. Korea should perhaps focus its attention and efforts to promoting the region-wide East Asian FTA, EAFTA, as contained in the Vision for East Asia outlined by the East Asian Vision Group, and officially adopted by the East Asian Study Group.

### **In Search of Guiding Principles**

It may well be that a number of East Asian economies will continue to initiate bilateral and sub-regional PTAs. This is a political reality. Therefore, basic guiding principles need to be developed so that the political pressures to develop PTAs can be channeled in ways that maximize their potential benefits while minimizing the risks. In regard to this, the following developments need to be taken into consideration.

- First, PTAs in East Asia, including ASEAN, are being pursued within a “multi-layered” trade policy involving bilateral, regional and multilateral initiatives. A number of governments in the region appear to be confident that they can pursue all trade policy options at the same time. The fact is that the many PTA proposals absorb a

lot of attention and scarce policy-making resources. Perhaps unintentionally, these PTAs create a systematic threat to the WTO.

- Second, the PTAs deal with a wider range of issues beyond border barriers to trade and investment, but these comprehensive agreements tend to be constructed around a FTA as the core. This is not the case with the agreements involving Singapore, which tend to be built around services liberalization. It remains to be seen whether or not those services liberalization commitments will subsequently be multilateralized.

- Third, a number of countries are joining in the PTA game or will do so essentially for defensive reasons, namely in order not to be left out. This has created greater confusion as countries become more and more unclear where all these PTAs will at the end lead to.

- Fourth, the various PTAs in East Asia are pursued in an uncoordinated fashion. Lack of coordination or clarity not only exist region-wide but also within an individual country. A case in point is Japan. It is said that the Ministry of Foreign Affairs is adopting the misguided approach of developing bilateral FTAs with selected ASEAN countries while METI is promoting an agreement with ASEAN as a group. Thailand may also become a spoiler by pursuing its own bilateral FTA with China although there is already an ASEAN-

China agreement that includes a FTA component. ASEAN members have yet to develop a common strategy to dealing with PTAs as part of a common external trade policy.

- Fifth, bilateral PTAs have not been able to deal with the sensitive sectors of their participants. Even though Singapore does not have a meaningful agricultural sector, during the FTA negotiations with Japan the issue of gold fish exports became a major issue. It is questionable whether Japan will be more ready to dismantle its agricultural protection through bilateral or sub-regional arrangements rather than multilaterally through the WTO negotiations. It was also reported that US is willing to commit to introduce more liberal rules of origin (RoO) for textiles in the FTA only if further liberalization on RoO is achieved in the WTO (Nanto, 2003).

- Sixth, the private sector in ASEAN and East Asia has yet to understand the implications of the diverging RoO on transaction costs. Singapore's bilateral FTAs with New Zealand, Japan, EFTA, Australia and the US have resulted in a complex and varied rather than a one-size RoO design (Low, 2003). It is in the interest of the region to make the provisions to harmonize and adopt common RoO methods that are simple, transparent and liberal.



If PTAs are to function as stepping stones (or building blocks) to multilateral free and open trade, in the first place they should contain provisions that ensure that the benefits are subsequently extended on a MFN basis (Findlay et al., 2003). Some ASEAN

countries have adopted this policy, formally or informally, in implementing the ASEAN Free Trade Area (AFTA). If East Asia could agree to adopt this principle in any of its future FTAs, this could set a positive precedence to others. APEC can encourage this.

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