

The Evolution of ASEAN+X Free Trade Agreements: Implications for Canada

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ABSTRACT

This essay examines the question of whether Canada should also form an FTA with ASEAN. The first section will provide an update on the status of the various FTA agreements that ASEAN has signed since 2002. This will be followed by an examination of these FTA agreements in relation to the ASEAN Community project and the proposal to form an East Asian Free Trade Area (EAFTA). The concluding section briefly discusses the implications for Canada and other major trading partners as well as for APEC and trans-Pacific relations in general, and suggests ways to improve Canada's diplomatic and commercial relations with ASEAN.

Keywords: *ASEAN, Canada, free trade arrangement (FTA)*

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Introduction

Canada is an ASEAN dialogue partners since 1977. In 1981 ASEAN and Canada signed an Economic Cooperation Agreement (ACECA). This agreement was revised in 1993. At the latest ASEAN-Canada Dialogue on 30-31 March 2004 in Bandar Seri Begawan (Brunei Darussalam), both sides noted that trade and investment between the two countries had steadily increased over recent years and they agreed that there is great potential to further expand and deepen their scope in the near future. The Canadian side expressed an interest “to update and broaden the scope of its relationship with ASEAN to include new dimensions, especially in the area of economics and trade”. The ASEAN side regarded the Dialogue as “an important development in revitalizing the ASEAN-Canada relations.” (Co-Chairs Statement, ASEAN-Canada Dialogue, 30-31 March 2004).

In April 2005 a Canada-ASEAN Trade and Investment Summit will be held in Toronto. Is an initiative of this kind sufficient to direct ASEAN’s attention and energies towards enhancing its economic and trade relations with Canada when ASEAN is pre-occupied with its ASEAN Economic Community project and a series of Free Trade Agreements (FTAs)? The Framework Agreements that ASEAN has signed with a number of countries since 2002 all have a FTA component. It is the FTAs that are capturing the attention of ASEAN policy makers and the public. Should Canada follow the footsteps of China, Japan, South Korea, India or Australia and New Zealand in forming an FTA with ASEAN? Canada is currently negotiating a bilateral FTA with an ASEAN member, namely Singapore. Should this be seen as a precursor to a FTA with ASEAN as a whole?

This essay is an attempt to give some preliminary answers to those questions. The first section will provide an update on the status of the various FTA agreements that ASEAN has signed since 2002. This will be followed by an examination of these FTA agreements in relation to the ASEAN Community project and the proposal to form an East Asian Free Trade Area (EAFTA). The concluding section briefly discusses the implications for Canada and other major trading partners as well as for APEC and trans-Pacific relations in general, and suggests ways to improve Canada's diplomatic and commercial relations with ASEAN.

ASEAN's FTAs

It all began with the approaches by China. ASEAN on its part did not regard free trade areas (FTAs) as a major element in its international economic diplomacy. ASEAN's own economic integration has been the priority since the decision in 1992 to form an ASEAN Free Trade Area (AFTA), which was followed by initiatives in the fields of investment (AIA) and services (AFAS), and a few other measures. Beyond ASEAN, its trade liberalization efforts are directed at the multilateral level, the WTO's Doha Development Agenda. At the regional level, ASEAN members of APEC attempt to continuously improve their Individual Actions Plans (IAPs) under the region's modality of concerted unilateral liberalization towards free and open trade and investment in the region in 2010/2020. APEC, as distinct from WTO, is a voluntary and non-binding process. The proposal for an East Asia Free Trade Agreement (EAFTA) was presented by an East Asian Vision Group to the ASEAN+3 leaders as a means to realize an East Asian community, but EAFTA is seen as a long-term effort.

In 2001, at the ASEAN-China Summit in Bandar Seri Begawan, China came up with a proposal to establish an ASEAN-China Free Trade Area within ten years. It was understood in many quarters in ASEAN that the agreement reached at that Summit was only to study the proposal. In the course of the development, however, both sides were engaged in a negotiation. Within one year, at the Summit meeting in Phnom Penh in

November 2002, the Heads of State of ASEAN and China were ready to sign a Framework Agreement on Comprehensive Economic Cooperation (CEC), which included a FTA.

There is no doubt that China's proposal essentially was politically motivated (Sheng, 2002; Soesastro, 2003), but China and ASEAN both saw the economic significance of the initiative. However, the process appeared to have been driven largely by China. Having participated in a lengthy and difficult process of WTO accession, China has acquired sufficient expertise to negotiate a trade deal. The deal was made attractive for ASEAN with the introduction of an Early Harvest program. In a way, it can be said that ASEAN, at least initially, was dragged along by China. China's initiative was immediately followed by a proposal from Japan. This was to be expected as Japan naturally did not want to be left out. Since then ASEAN has been courted by other countries and have entered into an agreement with a few other countries. However, to date there is as yet no ASEAN document that clearly spells out ASEAN's strategy of engagement in FTAs with its trading partners.

ASEAN-China

The Framework Agreement on CEC contains three elements: liberalization, facilitation, and economic cooperation. In addition it has a provision on the mechanism to implement the Agreement, including a dispute settlement mechanism. The liberalization element covers trade in goods, trade in services, and investment. In the context of liberalization, the Agreement provides for special and differential (S&D) treatment and flexibility to the newer ASEAN members as well as flexibility to address sensitive areas.

The Framework Agreement contains an Early Harvest program that covers all products in chapters 01 to 08 at the 8/9 digit level (HS Code): live animals; meat; fish; diary produce; other animals products; live trees; edible vegetables; and edible fruits and nuts. Products under this program are divided into three categories for tariff reduction and elimination, but tariffs will have to be brought to zero for all three categories within three years.

However, the program allows for an Exclusion List and different timeframes between the ASEAN-6 (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) and the CLMV (new members – Cambodia, Laos, Myanmar and Vietnam), for whom zero tariffs will be reached in 2010. Initially it was thought that China would offer the Early Harvest program on a non-reciprocal basis, but this turned out not to be the case. Moreover, some agricultural commodities of great interest to ASEAN, such as rice and palm oil, were excluded from the program. Some ASEAN countries (e.g. the Philippines) did not immediately join the program.

Beyond the Early Harvest, tariff reduction and elimination will be pursued along two tracks, the normal track and the sensitive track. Applied MFN tariffs of products listed in the normal track should be gradually reduced or eliminated in accordance with specified schedules and rates over a period from 1 January 2005 to 2010 for ASEAN-6 and China, and over a period from 1 January 2005 to 2015 for CLMV. Reduction of tariffs of products in the Sensitive List will be in accordance with mutually agreed end rates and end dates. The number of products in the Sensitive List is subject to a maximum ceiling, also to be mutually agreed upon.

The Framework Agreement was amended on 6 October 2003. The Protocol of amendment incorporated the Rules of Origin (ROO) applicable to the products covered under the Early Harvest program. It also included subsequent Early Harvest agreements between some ASEAN members and China, and it clarified the implementation of the provision of the program as well as the terms and conditions for the acceleration of the tariff reduction and elimination through bilateral or plurilateral agreements.

The negotiation on the FTA for goods (beyond the Early Harvest) was to be concluded by 30 June 2004. This was a rather ambitious timeframe, and indeed, the deadline was missed. The parties could not agree on the maximum number of tariff lines in the sensitive list. However, as political leaders were determined to begin the process of tariff reduction and elimination on 1 January 2005, a compromise was struck, and Ministers

were able to sign an agreement at the ASEAN Summit in Vientiane in November 2004. This does suggest the importance of setting target dates.

The Agreement on Trade in Goods of the Framework Agreement on CEC, or for short, the ASEAN-China FTA (ACFTA), is only the first portion of a series of agreements to implement the Framework Agreement. At the Vientiane Summit, Ministers also signed an Agreement on Dispute Settlement Mechanism of the Framework Agreement on CEC. They will be followed by an agreement on services, an agreement of investment, and other agreements. It is indeed rather surprising that ASEAN and China were able to produce those two agreements within a short time.

The ACFTA contained the modality for tariff reduction and elimination for tariff lines both in the normal track and the sensitive track. In the normal track there are three sets of schedules. The first applies to ASEAN-6 and China. The implementation will begin on 1 July 2005, when applied MFN tariff rates will be brought down to 20%, 15%, 10% and 5% for tariffs still above 5%. By 2007 they will be reduced to 12%, 8% and 5%, and by 2009 to 5% and 0%, and finally by 2010 all rates will become zero. The second schedule applies only to Vietnam, where all tariffs will be brought down to 0% in 2015. The third schedule applies to Cambodia, Laos and Myanmar, where some tariffs will still be higher than in Vietnam's schedule, but from 2011 onwards they will be the same.

In addition, agreement was also reached to bring as many tariff lines to the 0-5% range. For instance, for ASEAN-6 and China, by 1 January 2007 at least 60% of tariff lines placed in the normal track must be reduced to 0-5%. However, some "flexibility" is allowed in 2010, whereby up to 150 tariff lines could still have tariffs but should be eliminated not later than 1 January 2012. For the CLMV countries, this flexibility allows for having tariffs on up to 250 tariff lines to be eliminated not later than 1 January 2018.

In terms of tariff lines in the sensitive track, the Agreement subjects the number of tariff lines to a maximum ceiling. Tariff lines in the sensitive track are further classified into Sensitive List and Highly Sensitive List. For ASEAN-6 and China, the maximum ceiling

is 400 tariff lines at the HS 6-digit level and 10% of total import value, based on 2001 statistics. The Highly Sensitive List should have not more than 40% of the total number of tariff lines in the sensitive track or 100 tariff lines at the HS 6-digit level, whichever is lower. For CLMV, the maximum ceiling is 500 tariff lines. To note, tariff lines at the HS 6-digit level for the ASEAN-6 countries varies between 5,600 (Philippines) and 10,400 (Malaysia). The number of tariff lines in the Sensitive and Highly Sensitive Lists is shown in Table 1. Applied MFN tariff rates in the Sensitive List must be reduced to 20% not later than 1 January 2012 and to 0-5% not later than 1 January 2018. For CLMV countries, the target dates are 1 January 2015 and 1 January 2020, respectively. In any case, the sensitive track will be reviewed in 2008.

Table 1 ASEAN-China FTA: Tariff Lines in Sensitive and Highly Sensitive Lists
(HS 6-digit)

Country	Sensitive	Highly Sensitive
Brunei	66	34
Cambodia	350	150
Indonesia	349	50
Lao PR	88	30
Malaysia	272	96
Myanmar	271	0
Philippines	267	77
Singapore	1	1
Thailand	242	100
Vietnam
China	161	100

The modality for tariff reduction and elimination in this Agreement resembles AFTA's CEPT (Common Effective Preferential Tariff) reduction scheme. Experience in AFTA suggests that this modality does result in reductions in accordance with the schedule and in fact also brings about acceleration in the reduction and the progressive transfer of tariff lines from the sensitive track to the normal track.

The Rules of Origin (ROO) for the ACFTA as stipulated in the Agreement (Annex 3) are as follows: "a product shall be deemed to be originating if: (i) Not less than 40% of its content originates from any Party; or (ii) If the total value of the materials, parts or produce originating from outside of the territory of a Party (i.e. non-ACFTA) does not exceed 60% of the FOB value of the product so produced or obtained provided that the final process of the manufacture is performed within the territory of the Party." In addition the Cumulative Rule of Origin applies provided that the aggregate ACFTA content, i.e. full cumulation, applicable among all Parties, on the final product is not less than 40%. Also, products that satisfy the Product Specific Rules, i.e. products that have undergone sufficient transformation in a Party, will be treated as originating goods of that Party. The ROO in the ACFTA is also similar to that in AFTA. It is relatively simple and quite liberal. In fact, ACFTA should be commended for this, and perhaps is an example of "best practice" in this regard.

It is also to be noted that the ACFTA explicitly adopts GATT 1994 provisions on national treatment on internal taxation and regulation, transparency, BOP safeguard measures. It also abides to the provisions of the WTO disciplines on, among other things, non-tariff measures, technical barriers to trade, sanitary and phyto-sanitary measures, subsidies and countervailing measures, anti-dumping measures and intellectual property rights.

The Agreement on Dispute Settlement centers on arbitral proceedings in case consultations fail to settle a dispute. The Agreement stipulates the appointment, composition, functions and proceedings of Arbitral Tribunals. It enters into force on 1 January 2005. How well this mechanism will function will be known only when it is

being used. This mechanism is perhaps more straightforward than the one recently adopted by ASEAN as part of its efforts to realize the ASEAN Economic Community. The ASEAN mechanism is yet to be tested as well.

The ACFTA might become a model for other ASEAN FTAs, particularly if the partner country is a developing country. It should be noted that while tariff reduction and elimination are scheduled to be completed in 2010 for the ASEAN-6 and China, and 2015 for the CLMV countries for the normal track, reduction of tariff lines in the sensitive list (to 0-5%) could be extended to 2018 and 2020, respectively. It should be in interest of ASEAN and China to try to accelerate this process. The modality adopted in the Agreement can accommodate this. However, political will has to be there for this to happen. It also should be noted that the ACFTA is only the first step in the implementation of the Framework Agreement. Negotiating an agreement in services and investment may prove to be more difficult.

To conclude on a more optimistic note, it may well be that ASEAN's engagement in FTAs with other trading partners could create a kind of competition amongst the various FTAs that might lead to acceleration of their completion.

ASEAN – Japan

In January 2002, during his visit to Singapore, Prime Minister Koizumi of Japan announced Japan's interest to form an Economic Partnership agreement with ASEAN, which might have a FTA component. Japan has completed a bilateral FTA with Singapore, the Japan Singapore Economic Partnership Agreement (JSEPA), which is the first FTA for Japan. Japan also wants to develop FTAs with individual ASEAN countries on a bilateral basis. It was immediately obvious that Japan was reacting to the earlier move by China towards ASEAN that led to the decision in November 2001 to develop an ASEAN-China Comprehensive Economic Cooperation Agreement.

At the ASEAN-Japan Summit in November 2002, in their Joint Declaration the Heads of State/Governments agreed to implement measures for the realization of a Comprehensive Economic Partnership (CEP), including elements of a possible FTA, which should be completed as soon as possible within 10 years. A Committee was established to draft a framework for the realization of an ASEAN-Japan CEP.

In October 2003 in Bali ASEAN and Japan signed a Framework for Comprehensive Economic Partnership (CEP). Both sides agreed to adhere to the following principles:

- (a) The ASEAN-Japan CEP should involve all ASEAN members and include a broad range of sectors focusing on liberalization, facilitation and cooperation activities;
- (b) The integrity, solidarity and integration of ASEAN will be given consideration in the realization of the ASEAN-Japan CEP;
- (c) The Agreement should be consistent with the rules and disciplines of the WTO Agreement;
- (d) Special and differential treatment should be provided to ASEAN members in recognition of their different levels of economic development, and additional flexibility should be accorded to the newer ASEAN members;
- (e) Flexibility should be given to address the sensitive sectors in each ASEAN member and Japan; and
- (f) Technical cooperation and capacity building programs should also be considered.

The above suggests that an ASEAN-Japan CEP will not be too different from ACFTA, except that there will be no Early Harvest program. The Japanese side has insisted that the Agreement should be a “single undertaking”. The negotiations were scheduled to begin in 2005. It remains to be seen whether such a single undertaking could be negotiated within a reasonable time frame. Both sides want to realize the Agreement by 2012.

An Agreement with Japan, being a developed economy, must strictly adhere to Article XXIV of the WTO to cover substantially all trade. There cannot be a long Exclusion List

of sensitive items. The ACFTA could avail itself of the WTO enabling clause. Nonetheless ASEAN and China agreed to limit the so-called sensitive track to 10% of total import value. The Japanese side has made it known that in their understanding “substantially all trade” could mean at least 90% of the value of trade. This still has to be negotiated with ASEAN. It should also be closely observed whether the ASEAN-Japan CEP will adopt an equally simple and liberal Rules of Origin (ROO) as in AFTA and ACFTA.

The problem is that Japan already has a bilateral agreement with an ASEAN country, Singapore, which has adopted a ROO that is less liberal than AFTA and ACFTA, and Japan is now negotiating similar agreements with Thailand, the Philippines and Malaysia. It is not immediately clear whether the ASEAN countries will insist on the adoption of AFTA’s ROO in their bilateral FTAs with Japan. The CEP between ASEAN and Japan signed in Bali stipulated that schedules of liberalization concessions between Japan and individual ASEAN countries that have concluded a bilateral FTA or EPA (Economic Partnership Agreement) will not be renegotiated and will be annexed to the ASEAN-Japan CEP Agreement. Nothing is said about the ROO.

Japan has adopted a dual strategy in regard to negotiating free trade agreements with ASEAN, namely with ASEAN as a group and selectively with certain ASEAN countries. The strategy is to move faster on the latter. It has been said that the origin of this dual strategy was bureaucratic in that METI was championing for an agreement with ASEAN while Gaimusho (MOFA) preferred bilateral agreements. MOFA thought that it would be very difficult for Japan to have FTAs with the CLMV countries.

How Japan will handle this problem in the ASEAN-Japan CEP is unclear. It can make use of the S&D principle to provide a longer time frame for the CLMV countries as in the case of ACFTA. However, since Japan is negotiating bilateral FTAs with most of ASEAN-6, it could well be that the liberalization schedules will be different even amongst ASEAN-6, and that similar agreements with CLMV will be postponed to a later date. The focus of the agreement with CLMV will be initially on facilitation and

cooperation. This could suggest that the ASEAN-Japan CEP will essentially be an umbrella agreement for separate FTAs. It is unclear whether this is consistent with the principle of a single undertaking.

In this sense, the agreement with Japan could be different from the agreement with China. In the ACFTA, ASEAN can act as a “hub”, but in relation to Japan, ASEAN countries could become “spokes”.

ASEAN – India

In 2002 ASEAN and India agreed to enhance economic cooperation and to work towards an ASEAN-India Regional Trade and Investment Area (RTIA). Amongst the ASEAN countries Singapore has been the main promoter of increased economic and trade relations with India.

In October 2003 in Bali the ASEAN and India Heads of State/Governments signed a Framework Agreement on Comprehensive Economic Cooperation (CEC). It entered into force on 1 July 2004. This Framework Agreement is very similar to, and appeared to have been largely inspired by, the ASEAN-China Framework Agreement. It also introduced an Early Harvest program. The Early Harvest program commenced from 1 November 2004, with tariff elimination to be completed by 31 October 2007 for ASEAN-6 and India, and 31 October 2010 for the CLMV countries.

The schedule to liberalization in the normal track will be over a period from: (i) 1 January 2006 to 31 December 2011 for Brunei Darussalam, Indonesia, Malaysia, Singapore and Thailand, and India; (ii) 1 January 2006 to 31 December 2016 for the Philippines and India; and (iii) 1 January 2006 to 31 December 2016 for the CLMV countries. The timeframes for liberalization in the sensitive track have not been specified in the Framework Agreement and will be mutually agreed upon among the Parties.

The ROO negotiation was to be concluded by 31 July 2004, but the deadline has been missed. In fact, the negotiation has been difficult and becomes the main obstacle in the entire process, including the implementation of the Early Harvest. The Indian side has not agreed to adopt ASEAN's simple and liberal ROO, as applied also in the agreement with China, and the ASEAN side has not been willing to compromise on this.

ASEAN – Republic of Korea (ROK)

Until recently, Korea resisted to take part in the bilateral FTA game with ASEAN. Then President Kim Dae-jung was more interested in promoting the East Asia Community idea. His successor, President Roh, also focuses his attention to initiatives in Northeast Asia, where Korea is to be developed as a business hub. In the end, however, Korea felt that it cannot afford to be left behind by the other Northeast Asian (+3) countries.

A Joint Declaration on Comprehensive Cooperation Partnership (CCP) was signed at the Summit in Vientiane in November 2004. The establishment of an ASEAN Korea FTA (AKFTA) is seen as “a natural extension of the existing relations as well as a stepping stone to elevate the ASEAN-ROK relationship to a higher and more comprehensive level.”

AKFTA will be similar to other ASEAN FTAs in terms of its comprehensive scope and provision for flexibility to deal with the CLMV countries. The possibility of achieving Early Results will be considered in developing a Framework Agreement. However, the kind of Early Harvest program to be included will not be confined to agricultural products as in the case of the ASEAN-China CEC, but will include manufactured products that are not sensitive to either side. In fact, it might exclude many agricultural products.

The negotiations on AKFTA will commence in early 2005 and completed within two years. While AKFTA was conceived at a much later date than the other FTAs, the intention is to realize it at an earlier date, with a goal of achieving as high a level of

liberalization as possible, whereby at least 80% of products will have zero tariffs in 2009, and with consideration for S&D treatment and additional flexibility for the CLMV countries.

AKFTA may well be the Agreement that will drive other FTAs to accelerate their implementation. This could substantiate the point that was made earlier.

AFTA – CER

A linkage between AFTA and CER (Closer Economic Relations between Australia and New Zealand) was established as early as September 1995. This led to the establishment of a High Level Task Force on an AFTA-CER FTA. The Task Force report, *The Angkor Agenda*, was presented to Ministers from ASEAN, Australia and New Zealand on 6 October 2000 in Chiang Mai (Thailand).

It should be noted that the idea of an AFTA-CER FTA was proposed at an earlier date than the ASEAN-China FTA. The AFTA-CER FTA discussions failed to lead to an agreement. The ASEAN side was not ready to embark on this initiative. It was also not launched at a Summit level. Perhaps it was an idea whose time had not arrived. There were sensitivities on the part of ASEAN to engage in a narrow FTA. The ASEAN side demanded that Australia and New Zealand undertake some facilitation and development cooperation efforts as a prerequisite for the negotiation.

In September 2001 the two sides revisited the idea of promoting closer economic relations and endorsed a new Framework for AFTA-CER Closer Economic Partnership (CEP). In September 2002, a Ministerial Declaration on the AFTA-CER CEP was signed. The CEP is regarded as a building block for greater economic integration. The fields of cooperation under the CEP will be broadened to include, but not limited to, promoting and facilitating trade and investment, capacity building, new economy issues and other areas of cooperation.

However, since relations between Australia and some ASEAN countries were rather cool, not much was happening in terms of implementing the CEP agreement. It was only in Vientiane in November 2004 at the ASEAN-Australia and New Zealand Commemorative Summit that the Leaders revived the idea of a FTA between ASEAN and Australia and New Zealand. The Joint Declaration of the Leaders announced the launching of negotiations on a FTA, to commence in early 2005 and to be completed within two years, as is the case of the ASEAN-Korea FTA.

The Annex to the Joint Declaration stipulates the guiding principles for negotiating a FTA. The FTA will be comprehensive in scope. All barriers to trade in goods, services and investment will be progressively eliminated. It should build on members' commitments in the WTO. It also will have a provision of flexibility as in the other ASEAN FTAs. The hope is that the FTA will be fully implemented within 10 years.

The US "Enterprise for ASEAN Initiative"

During the APEC meeting in Mexico in 2002, President Bush announced the Enterprise for ASEAN Initiative (EAI). This Initiative is aimed at strengthening US economic and politico-security relations with Southeast Asia. It has often been interpreted as an initiative to support the US fight against global terrorism.

The Initiative is to develop FTAs between the US and selective ASEAN countries. The US already concluded a FTA with Singapore. ASEAN countries that have concluded a TIFA (trade and investment facilitation agreement) with the US are eligible. Brunei Darussalam, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam now have such agreements with the US.

Thailand is already negotiating with the US, and approaches have been made with Indonesia, the Philippines and Malaysia. The US is also negotiating FTAs with other countries and sub-regional groupings in other parts of the world. It can only handle a few negotiations at a time. It will only negotiate with a country that it regards ready to make

significant commitments. In the case of Indonesia, for instance, the US has put some conditionalities, which include the resolution of current trade disputes involving chicken legs exports from the US and the strengthening of intellectual property protection in Indonesia, especially in relation to optical disks.

It remains to be seen in how far the second Bush Administration, and the new USTR, will put their priority on ASEAN. An agreement with the US will bring about more wide ranging reforms domestically in the ASEAN countries. The US will also put greater emphasis on services liberalization. However, US ROO tends to be rather restrictive, especially in such areas as textiles and clothing.

In the foreseeable future the Enterprise for ASEAN Initiative will consist of separate bilateral FTAs with the US. The US has not considered developing a Framework Agreement (or an umbrella agreement) with ASEAN as a whole. In the 1980s such kind of an umbrella agreement was developed, the US-ASEAN Initiative (UAI), and at that time there was only the ASEAN-6. Even so, there was no follow up to it.

Implications for ASEAN and East Asia

ASEAN has a huge agenda. Its priority is to deepen economic integration amongst its 10 members. This is a major undertaking in view of the big differences in levels of economic development and economic openness. When AFTA was decided in 1992, ASEAN only had the six members. When joining ASEAN the new members had to accede to the AFTA agreement. They were each given longer time frame. A two-tier ASEAN was created.

In 1997, ASEAN-6 and the new members, charted a new direction, the ASEAN Vision 2020, with the aim to forge closer economic integration and narrowing the gap in the level of development amongst its members. The vision is to “create a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods,

services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities.”

In 2003, at the Summit in Bali, ASEAN leaders agreed to establish an ASEAN Economic Community (AEC) by 2020. The AEC is one of three pillars (the other two being the ASEAN Security Community and the ASEAN Socio-cultural Community) that make up the ASEAN Community. In line with the ASEAN Vision 2020, it is envisaged that the AEC will be a single market and production base with free flow of goods, services, investments, capital, and skilled labor. The AEC remains vaguely defined. The AEC has been conceptualized as a “FTA-Plus” arrangement that covers a zero-tariff ASEAN free trade area and some elements of a common market. The alternative is “Common Market Minus”, meaning that by 2020 the AEC would be declared a Common Market but it would take into account areas where members countries could reserve deeper integration for a later stage. On this discussion see Hew and Soesastro (2003). ASEAN officials opted for a pragmatic approach, essentially moving on a sectoral basis. Eleven priority sectors have been selected for fast-track integration. The eleven sectors are: wood-based products, automotives, rubber-based products, textiles and apparels, agro-based products, fisheries, electronics, e-ASEAN, healthcare, air travel, and tourism. A roadmap is being drawn for each sector. What remains missing is the overall roadmap towards achieving AEC, although ASEAN has produced an internal document, Roadmap for ASEAN Integration, prior to the decision to move towards an AEC.

At the same time that ASEAN undertakes its AEC project, it has been dragged into FTAs with a number of trading partners. Two immediate issues confront ASEAN. First, can these FTAs be completed before ASEAN realizes the AEC? In terms of the plan (intention), ASEAN-Korea FTA will be completed in 2009, ASEAN-China in 2010, ASEAN-India in 2011, and ASEAN-Japan in 2012, all with some built-in “flexibility”, allowing for some countries or some sectors to be realized later. However, the AEC is scheduled for completion by 2020. This means that ASEAN members must try to accelerate the implementation of their AEC initiatives. At least the fast-track sectors should be fully liberalized by 2010. ASEAN could also adopt an approach which clearly

defines the minimum measures to be taken for the region to become a single market and production base, namely so-called “core” elements of the AEC, and all members should agree to implement them by 2010. It is proposed that the following five elements constitute core elements of AEC: full liberalization of goods trade, free and open investment, selective services liberalization, infrastructure development (especially linking CLMV to the rest of ASEAN), and institutional mechanisms (in particular a dispute settlement mechanism). All other key elements will be called “defining” elements, and should be implemented between 2010 and 2020 (Soesastro, forthcoming).

The second issue regards the need for ASEAN to develop a common framework for its extra regional cooperation, particularly in forming FTAs. A common framework would make it easier for the various FTAs (or RTAs – regional trading arrangements) to become building blocks for or to be amalgamated into wider regional arrangements. More importantly, in so doing ASEAN can become a “hub” to drive the process in East Asia through the ASEAN+1 agreements. In addition, a common framework can help reduce tensions between ASEAN members. As some ASEAN members (e.g. Singapore) have moved faster in developing FTAs, there is an additional, practical reason for having a common framework. The Singapore-New Zealand FTA has been referred to as a model for non-restrictive ROO. Bilateral FTAs involving ASEAN members should have harmonized ROOs along lines of Singapore-New Zealand.

Finally, for ASEAN to become a production base, it also needs to minimize business transaction costs by having similar rules and schedules of tariff reduction to ensure use of most efficient supplier. Most important in this regard is the Rules of Origin (ROO), which constitute one of the elements of a common framework. Restrictive ROO constrains sourcing of inputs. New ROO can also change sourcing decisions away from use of inputs from existing partners. In essence, a common ROO can facilitate the spread of full cumulation and the development of regional production networks. In its FTA with the US, Singapore has introduced two new approaches in calculating ROO that takes into account regional production networks. The first is the principle of outward processing that recognizes manufacturing chains and outsourcing. The second is the so-called

Integrated Sourcing Initiative (ISI), allowing parts and components produced in Singapore's neighboring countries as coming from Singapore, but this is limited to certain non-sensitive items only (IT components and medical devices).

Beyond trade in goods, a common framework also needs to be developed for services and investment, and perhaps also competition policy and IPR. Many of these elements form an integral part of the AEC project.

The implications for East Asia follow from this discussion. An East Asian FTA has been placed on the agenda of ASEAN+3, although this is seen as a longer term objective. At the Summit of ASEAN+3 in 1998, leaders decided to create an East Asian Vision Group. The Report of the Vision Group was submitted to the leaders at the Summit in 2001. The Vision Group envisions "East Asia moving from a region of nations to a bona fide regional community where collective efforts are made for peace, prosperity and progress. The economic field, including trade, investment, and finance, is expected to serve as the catalyst in this community-building process." One of its key recommendations is the formation of an East Asia Free Trade Area (EAFTA) and liberalization of trade well ahead of the Bogor Goal set by APEC. It suggested that in order to facilitate the formation of a region-wide FTA, East Asia needs to consolidate all existing bilateral and sub-regional FTAs within the region. The Group further recommended the establishment of a ministerial committee to oversee the development of an EAFTA.

ASEAN+3 leaders established an East Asia Study Group (EASG), consisting of officials, with the mandate to assess the recommendations of the East Asian Vision Group, and to propose "a practical number of concrete measures that should be given high priority and are relatively easy to carry out." On the EAFTA proposal, the EASG was of the view that EAFTA will help boost intra-regional trade and investment. Its establishment may take the form of encompassing the bilateral and sub-regional FTAs. It further suggested that the implementation process of bilateral and sub-regional FTAs or FTA plus arrangements in East Asia be made transparent as much as possible by countries involved under the framework of ASEAN+3 consultations. It also noted that a ministerial committee already

existed in the form of the ASEAN+3 Economic Ministers Meeting. Finally, it also stated that the establishment of an EAFTA should take into account the differences in economic development of East Asian countries. At the ASEAN+3 Summit in Vientiane in November 2004 leaders exchanged views on the establishment of an EAFTA and welcomed the decision by the ASEAN+3 Economic Ministers to set up an expert group to conduct a feasibility study of EAFTA.

The Report of the EASG placed the formation of an EAFTA as “a long-term goal, taking into account the variety of differences in developmental stages and the varied interests of the countries in the region.” The officials could not hide their cautious stance, and they proposed that East Asian governments conduct a study on the impacts of an EAFTA on the region.

In academic and other non-government circles different approaches to forming EAFTA have been considered. One approach is through {3 x (ASEAN+1)}. The second is to first develop an arrangement in Northeast Asia (China, Japan, Korea), and subsequently link it to ASEAN. The third is an ASEAN+3 process. Although no efforts have been made to forge an agreement amongst East Asian governments on which approach to take, it appears that the {3 x (ASEAN+1)} is the route taken now that ASEAN and Korea have also agreed on forming a FTA. This suggests that ASEAN must act as a hub, which in turn means that ASEAN must strengthen and accelerate its efforts to realizing the AEC and must develop a common framework in its external economic relations as discussed above. This is in line with ASEAN’s position as the driver in the ASEAN+3 process. However, the ASEAN+3 process is in danger of being weakened by recent attempts to develop a parallel East Asian Summit process.

Implications for Canada and the Asia Pacific Region

Empirical studies generally show that the impact of an EAFTA or each of the 3 (ASEAN+1) arrangements on non East Asian economies could in general be negative (Scollay, 2003b). This could be the case for Canada or any other non East Asian APEC

member. The impact of the {3 x (ASEAN+1)} combined on Canada is likely to be smaller than the impact of EAFTA, because the integration of the Northeast Asian economies will have a greater impact on the world.

Two proposals can immediately be drawn from this. First, Canada or other non-East Asian APEC members may want to develop a trading arrangement (FTA) with ASEAN. It is not likely that ASEAN will now want to extend its arrangements beyond the countries with which it is currently engaged until they have been completed or consolidated. ASEAN's capacity is already stretched to its limits. There must be compelling reasons for ASEAN to favorably respond to an offer or invitation by Canada. Canada no longer belongs to the top ten export markets of ASEAN. It was in 1993. Australia and India are more important trading partners for ASEAN. Efforts should be made to rectify this. The Canada-ASEAN Trade and Investment Summit to be held in April 2005 could be an important initiative. Beyond this, Canada and ASEAN should strengthen the Partnership for the 21st Century which encompasses cooperation in various fields, including science and technology, energy, and human resources development.

The potentials are there for increased ASEAN-Canada relations in economics and trade as well as politically. Canada is a major economy and it is a member of the G-7. Canada is also a member of the huge NAFTA market. However, Canada cannot be used as a backdoor to NAFTA. That is why Singapore has concluded an agreement with The US and is currently negotiating separate FTAs with Canada and Mexico. It is likely that other ASEAN members (Thailand) will do the same. It is perhaps too far fetched to expect that this development might lead to an initiative to link AFTA and NAFTA in a similar fashion as the one that develops between AFTA and CER. This should, nonetheless, be explored at a future date.

Second, Canada and other non East Asian APEC members should strengthen and accelerate APEC's trade liberalization. Scollay (2003a) showed that APEC-wide liberalization can in general deliver greater benefits to APEC members, both collectively and individually, than any of the other possible regional trading configurations open to

APEC members. He also showed that this conclusion holds whether APEC-wide liberalization is pursued on a non-discriminatory basis in line with the concept of “open regionalism” or on a preferential basis. FTA initiatives in East Asia, led by the ASEAN+1 arrangements, should provide an incentive to strengthen and accelerate APEC-wide liberalization.

APEC trade liberalization can make progress if there are champions amongst its members. Canada should explore ways to take new initiatives in APEC. It will need to take a high profile, but it need not do this alone. It can develop initiatives in cooperation with ASEAN in trade and investment facilitation and liberalization as well as economic and technical cooperation.

Canada should explore both initiatives, and should do so in collaboration with ASEAN.

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