WILL ASEAN ECONOMIC INTEGRATION PROGRESS BEYOND A FREE TRADE AREA?

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I. INTRODUCTION

The raison d'être of ASEAN was a political one,[1] to secure the region's peace, stability, and development. Against all odds, the founding members, namely, Indonesia, Malaysia, the Philippines, Singapore, and Thailand signed the ASEAN Declaration on 8 August 1967. Brunei was admitted in January 1984, Vietnam in 1995, which was followed closely by Laos and Myanmar in 1997. Thirty-two years later, on 30 April 1999, ASEAN formally encompassed all ten countries of South-East Asia by admitting Cambodia.[2]

Following the collapse of the non-communist regimes in Cambodia and South Vietnam in 1975, and the rising communist insurgency that threatened to spread down south to Malaysia and Singapore, ASEAN felt a greater urgency to expand activities and cooperation beyond its original raison d'être. Thus, at the Bali Summit in 1976, ASEAN leaders adopted two landmark treaties which ushered in greater economic cooperation:[3] the Treaty of Amity and Cooperation in Southeast Asia, 1976[4] and the Declaration of ASEAN Concord, 1976.[5] Both treaties essentially called for active promotion and

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[1] South-East Asia was a region in tumult in the early 1960s. Singapore, Malaysia, and Brunei were struggling for survival and independence after being 'de-colonized' by Great Britain. Diplomatic ties between Malaysia and Philippines were severed between 1962–66 owing to the Sabah dispute. Then there was the confrontation between Indonesia and Malaysia; the separation of Singapore from Malaysia in August 1965, barely 3 years after merger with Malaysia; the Vietnam War, together with the threat of an expansion of communism to South-East Asia by the Chinese leaders during the Cultural Revolution of 1967, all of which contributed to the birth of ASEAN, see LK Yew *The Singapore Story-Memoirs of Lee Kuan Yew* (Singapore Press Holdings Times Editions 1998) 628–63.

[2] The ASEAN grouping can be roughly divided into two groups: (a) the original founding members and Brunei, collectively referred to as the ASEAN 6; and (b) the newer members of ASEAN, ie Vietnam, Laos, Myanmar, and Cambodia (VLMC) who share similar history and are emerging economies.

[3] DA Haas 'Out of Others' Shadows: ASEAN moves toward greater Regional Co-operation in the Face of the EC and NAFTA' (1994) 9:3 American University Journal of International Law and Policy 809 and 814.

[4] A copy can be obtained from the ASEAN Secretariat website at <http://www.aseansec.org/print.asp?file=/summit/amity76.htm>.

[5] A copy can be obtained from <http://www.aseansec.org/print.asp?file=/summit/concord.htm>.

[*ICLQ* vol 53, October 2004 pp 935–967]

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

cooperation in the economic field, including the adoption of regional strategies for economic development. These include, for example, the establishment of ASEAN industrial plants to meet the regional requirements for essential commodities, the ASEAN preferential trading arrangements, and the 'complementation schemes'.

In this article I will look at the history of ASEAN economic cooperation that culminated in the watershed ASEAN Free Trade Agreement (AFTA) in 1992. I am concerned with answering one central question, which is whether ASEAN economic integration will ever progress beyond a free trade area. I will examine the issue looking at the trade and investment laws and policies adopted by the ASEAN leaders in their endeavour to form a regional grouping.

II. OVERVIEW OF ASEAN ECONOMIC COOPERATION

A. ASEAN Industrial Projects Scheme (AIPs)

AIPS were introduced in 1976. They encompassed large-scale, capital-intensive ventures financed by the ASEAN governments to respond to regional demand and ensure a more efficient use of regional resources. Under the agreement, ASEAN members agreed to allocate an industrial project to each member.[6] The host country is required to subscribe 60 per cent of the equity needed for the project with the remaining 40 per cent supplied by the other four members. Out of the five AIPs inaugurated in 1976, only two of them became fully operational. Apart from the fact that many members could not decide which product to choose or could not raise the required 60 per cent of the original investment, more compelling reasons doomed these early industrial integration endeavours. Most of the members preferred to focus on national industrial development, and wanted to export more products to the broader world market rather than to the other ASEAN members.[7] Also, the ASEAN members were at that time more or less at the same level of development and they produced the same tradable goods. As a result, their manufacturing sectors were more competitive than complementary. Such a structure was in itself an impediment to market integration as they depended upon extra regional imports for machinery, intermediate goods and other inputs.[8] Lastly, the AIPs have generally failed because the private sector refused to cooperate.[9]

[6] Haas above n 3 at 817. The five original projects included two urea projects in Indonesia and Malaysia; soda ash in Thailand; superphosphate fertilizer in the Philippines; and a diesel engine project in Singapore.

[7] Ibid.

[8] A Nasution 'Open Regionalism: The Case of ASEAN FreeTrade Area' in W Moellers et al *ASEAN: Future Economic and Political Cooperation* (1992) 12, and N Thongpakde 'ASEAN Free Trade Area: Progress and Challenges' in M Than *ASEAN Beyond The Regional Crisis: Challenges and Initiatives* (2001) 49.

[9] Y Kodama 'Asia-Pacific Region: APEC and ASEAN' (1996) 30 The International Lawyer 388.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

B. ASEAN Industrial Complementation Scheme (AICS)

The AICS (established in 1981) and its variant, the Brand to Brand Complementation Scheme (established in 1988), were private-sector driven projects that aimed to facilitate horizontal specializations in the production of automotive components in the region. Components of specified brand models were given tariff preferences. The first AICS which sought to produce automotive parts across ASEAN was unsuccessful.[10] Nevertheless, six automotive companies from Japan and Europe were approved for the Brand to Brand Complementation Scheme.

Its sister scheme, the ASEAN Industrial Joint Ventures launched in 1983, was more flexible and covered a wider group of industries. The objective was to encourage greater investment into and within the region, and to increase industrial production through resource pooling and market-sharing activities.[11] In spite of incentives under the programme, only eighteen products have been accredited since its inception in 1983. Many of these programmes remained non-operational.[12] The schemes failed due to the lack of established goals and guidelines for negotiations over choice of product, investment, and market access[13] as well as slow bureaucratic red tape involved in the application process. Again, the schemes were not actively marketed to the private sector.

C. Preferential Trading Arrangements (PTAs)

The ASEAN PTA was launched in 1977 to jointly realize trade liberalization within the group. In the beginning, the margin of preference was only 10 per cent, and was negotiated on a voluntary, product-by-product basis. Local content of 50 per cent was required to enjoy preferential tariff rates. An exclusion list of 'sensitive items' was introduced to protect certain industries, which covered most parts of intra-ASEAN trade. The ASEAN governments were not too keen to accelerate ASEAN into a free trade area because their economies were not complementary, and they had to protect their domestic markets.[14]

Despite the margin of preference being later raised to 40 per cent and ASEAN content level reduced to 35 per cent with tariffs slashes across-the-board for imports of certain values, the PTA remained impotent. The exclusion lists (which were extensively used by the members to minimize the impact of the scheme) weakened the efforts to expand the coverage of

[10] Haas above n 3 at 818, and N Thongpakde above n 8 at 49–50.

[11] N Thongpakde above n 8 at 50.

[12] Haas above n 3, at 817 and CG Hernandez 'The ASEAN Free Trade Area: A Step Towards Economic Integration?' in M Than *ASEAN Beyond The Regional Crisis: Challenges and Initiatives* (1992) 26.

[13] Haas above n 3 at 818 and A Nasution above n 8 at 26.

[14] S Chirathivate 'ASEAN Economic Integration with the World through AFTA' in JLH Tan *AFTA in The Changing International Economy* (1996) 23–4.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

items.[15] The PTA's 50 per cent local content rule further showed that the arrangement was motivated by a regional import-substitution development strategy, rather than open trade and investment goals.[16]

D. Why the PTA Failed

The ASEAN PTA failed. Why? The reason was political. Like all newly independent States in the Third World Movement, ASEAN strenuously embraced self-independence and sovereignty. The ASEAN countries chose the strategy of Japan and South Korea in encouraging investments in export-intensive industries instead of inward-looking import-substitution policies. In other words, the ASEAN countries chose to integrate their economies with the global economy.[17]

ASEAN ideology has emphasized *national resilience*, accompanied by *regional resilience*. The concept of resilience encompassed strong national sovereignty. Thus even economic cooperation requiring national economies to adapt, to some degree, to regional adjustments had been difficult for the ASEAN countries. The priority of ASEAN leaders was, and still is, to strengthen and broaden their economic ties with third countries in the global economy. The support, if any, for the PTA was thus half-hearted. The item-by-item approach produced huge exclusion lists such that in the late 1980s the PTA covered only five per cent of total ASEAN trade. Very permissive criteria were used to formulate the exclusion list. The products for which substantial import revenues were collected got placed on the list as well as products which were important for employment. The PTA was not intended to establish a system of substantial tariff reductions. National trade policies prevailed and the average margin of preference varied from Singapore's 2 per cent to Thailand's 30 per cent. In the end, modest progress in the growth of PTA items was nullified by the increase of non-tariff trade barriers.[18]

III. THE CALL FOR DEEPER ECONOMIC INTEGRATION IN ASEAN

Growing consternation over the stalemated Uruguay Round and the onslaught of protectionist trade blocs forming in Europe and North America pushed ASEAN towards wider and deeper economic integration in the 1990s.[19]

[15] Ibid. Indonesia and Thailand excluded 54 per cent and 53 per cent respectively of their total items from the across-the-board tariff cuts. The figure for Malaysia was 37 per cent, the Philippines 25 per cent, and Singapore 2 per cent at 39.

[16] Kodama above n 9 at 385.

[17] E Palmujoki *Regionalism and Globalism in South-east Asia* (New York Palgrave 2001) 10–11.

[18] Palmujoki above n 16 at 50–2.

[19] M Rudner 'Institutional Approaches to Regional Trade and Co-operation in the Asia Pacific Area' (1994) 4 Transnational Law and Contemporary Problems 180. The new regionalism move-

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

ASEAN feared becoming an outsider in a world increasingly divided into trading blocs and further sensed the need to create a fallback position, should the Uruguay Round collapse. In addition, the ASEAN governments whose legitimacy depended heavily upon the high economic growth rates delivered to their electorate created the ASEAN Free Trade Area or AFTA in the hope that it would bring in increased investments to support the high growth rates. Lastly, the ASEAN members also worried that their markets might begin to look less attractive to foreign investors.[20]

IV. AFTA: THE ASEAN FREE TRADE AGREEMENT

A. Objective of AFTA

The primary motive of AFTA is to 'intensify cooperation among the members of ASEAN to increase their international competitiveness and integration with the world'. In other words, the ultimate objective of AFTA is to increase ASEAN's competitive edge as a production base geared for the world market.[21] Simulating intra-ASEAN trade is secondary.[22]

B. The Common Effective Preferential Tariff (CEPT) Scheme

AFTA was implemented through the CEPT scheme. Unlike the product-by-product approach of the PTA, CEPT adopts a sectoral approach. Fifteen product

ment that swept across the globe in the early to mid-1990s was owed partly to the change in attitude in the United States towards regionalism. The United States, a strong bulwark of the 'most-favoured-nation' non-discriminatory approach to trade liberalization, and the multilateral regime, changed its policy and began pursuing liberalization on a preferential basis. Preferential trading arrangements proliferating elsewhere, particularly in the European Community, were choking off US exports. As a result, it negotiated free trade agreements with Israel, Canada, and later NAFTA. Another reason for the move towards preferential arrangements is the 'GATT-frustration' factor. The GATT system was sclerotic prior to the conclusion of the Uruguay Round, see D Palmeter 'Some Inherent Problems with Free Trade Agreements' (1996) 27 Law and Policy in International Business 991–2 and C Primo Braga 'Comments on the Proliferation of Regional Integration Arrangements' (1996) 27 Law and Policy in International Business 963–4.

[20] Haas above n 3 at 823–5.

[21] AFTA Reader (1993) 1.

[22] The ASEAN secretariat has opined that since the implementation of the CEPT scheme, intra-ASEAN trade has grown from US$44.2 billion in 1993 to US$74.4 billion in 1999. This represents an average annual increase of 11.4 per cent, see TRADE <http://www.aseansec.org/economic/ov_trd.htm>. However, it is to be noted that although intra-ASEAN trade may have risen in absolute terms, it has remained fairly constant as a percentage of total trade of the ASEAN members. In 1990 intra-ASEAN trade constituted only 9.65 per cent of total trade of ASEAN members, and this figure climbed to 11.62 per cent in 1993 and finally to 12.35 per cent in 1998. The progress in intra-ASEAN trade was clearly dismal, see Direction of Trade Statistics (By Year) from 1990 to 1998. So far, the bulk of intra-ASEAN trade is accounted for by Singapore and Malaysia, and the driving force behind the growth in intra-ASEAN trade is intra-industry trade propelled by efficiency-seeking, cross-border investment by multinational enterprises, see P-C Athukorala and J Menon 'Foreign Direct Investment in ASEAN: Can AFTA Make a Difference?' in JLH Tan *AFTA In The Changing International Economy* (1996) 80.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

groups were immediately selected for accelerated tariff reductions.[23] The CEPT covered all manufactured products including capital goods and agricultural products.[24]

Concerned with the slowing down of the 'Asian miracle', the ASEAN leaders accelerated the creation of a free trade area by 5 years to January 2003 instead of 2008.[25] The 1997 Asian financial crisis further pushed the CEPT scheme forward by 1 year to 2002 for the ASEAN 6 countries. The VLMC countries were committed to bring tariffs to the 0–5 per cent category by 2003 for Vietnam, 2005 for Laos and Myanmar, and eventually zero tariffs by 2006 for Vietnam and 2008 for Laos and Myanmar.[26]

Under the CEPT, products that were slated for immediate liberalization through tariff reduction were put into an 'Inclusion List' (IL). The 2003 CEPT Package shows that 99.55 per cent of the ASEAN 6's IL are in the 0–5 per cent category.[27] Zero tariff rates will be achieved by 2010 for the ASEAN 6 members and 2015 for the VLMC countries with flexibility on some sensitive products until 2018.[28]

ASEAN members had the option of excluding products from CEPT in three instances: (a) temporary exclusion list; (b) sensitive agricultural products; and (c) general exception. The temporary exclusion list includes products for which the members are not yet ready to slash tariffs, such as Malaysia's automotive products.

The Sensitive List (SL) covers unprocessed agricultural goods which are given a longer time frame for integration into the free trade area.

The General Exception List (GEL) refers to products that are permanently excluded from CEPT for reasons of national security, moral and health hazards and articles of artistic, historic, and archaeological value. In 2003, there were 734 tariff lines in the GEL representing about 1.09 per cent of all tariff lines in ASEAN.[29]

[23] These products were of considerable commercial importance and account for roughly US$9.3 billion or 37 per cent of total intra-ASEAN trade, see MA bin Abdul Kareem *AFTA=Another Futile Trade Area?* (Kuala Lumpur Universiti Malaya 1994) 80.

[24] A Protocol in 1995 amended the CEPT to include raw and unprocessed agricultural goods.

[25] The same 1995 Protocol accelerated AFTA by 5 years to be realized on 1 Jan 2003.

[26] Statement on Bold Measures, 6th ASEAN Summit, Hanoi, 16 Dec 1998. A copy can be obtained at <http://www.aseansec.org/economic/investe/sum_bold.htm>

[27] In the latest trade report from the ASEAN Secretariat, it was reported that Vietnam will have 76.79 per cent of its Inclusion List with tariffs of 0–5 per cent by 2003; Laos and Myanmar will have 86.9 per cent and 83.43 per cent respectively of their Inclusion List at the tariff range of 0–5 per cent in 2005; and Cambodia, who only joined ASEAN in 1999, will reduce tariffs on 91.94 per cent of its Inclusion List to the 0–5 per cent range in 2007. The trade report can be obtained at <http://www.aseansec.org/print.asp?file=/economic/ov_trd.htm>

[28] Ibid.

[29] South-East Asia—A Free Trade Area, a copy can be obtained from <http://www.aseansec.org/viewpdf.asp?file=/pdf/afta.pdf>.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

C. Weaknesses in the CEPT Scheme

Despite its various improvements over the PTAs, the CEPT scheme is open to abuse and backtracking as each member decides on its own what products should be put into the IL, TEL, SL, or GEL. For example, Vietnam's GEL accounts for 5.9 per cent of its total tariff lines, more than three and a half times the general share in ASEAN. Its GEL contains 165 product categories and includes automobiles and motorcycles, computers, telecommunication and information technology equipment, petroleum products, beer, wine, alcoholic spirits, milk, tobacco, and sugar products.[30] Similarly in Laos, passenger motor vehicles, boats, jewellery, and various excise items such as cigarettes, beer, wine, whiskey, and petroleum have been classified under the GEL, and the Laos authorities admitted to using the list as an instrument to protect various sensitive products.

In another incident, Malaysia requested that in light of the Asian financial crisis, tariff cuts on its automotive sector should be delayed to 2005. Malaysia had always been protective of its automotive sector, and her request was opposed by Thailand which intimated that it will delay cuts on its palm-oil duties. Despite those rumblings, Thailand promised not to retaliate, and Indonesia also asserted that it would not seek a similar extension for its automotive sector.[31] Similarly, in January 2003, the Philippines announced that they will temporarily suspend tariff reduction on petrochemical resins and certain plastic products citing that continued tariff reduction would cause real problems towards establishing a fully viable domestic petrochemical industry.[32]

As AFTA was not intended to promote intra-ASEAN trade per se, the ASEAN leaders are therefore quite tolerant of abuses and backtracking. In view of AFTA's raison d'être, the Fifth ASEAN Summit in December 1995 heralded the creation of the ASEAN Investment Area, which is an AFTA-plus measure.

[30] JLH Tan 'Impact of Regional Currency Crisis on AFTA and Vietnam: A Singapore Perspective' presented at International Workshop on AFTA and ASEAN Economies in Perspective of the Asian Financial Crisis, Hanoi, Vietnam (1998).

[31] 'Tariff Troubles' *AsiaWeek* 1 Sept 2000, at 51.

[32] Executive Order No 161. A copy can be obtained from <http://www.aseansec.org/14284.htm>. Singapore and Thailand initiated consultations with Philippines on the matter under AFTA. In August 2003, Singapore and the Philippines reached an amicable agreement in which the Philippines agreed to pay compensatory adjustment measures to Singapore through a programme of tariff reductions of Singapore's exports to Philippines. The adjustment measures due in favour of Singapore would be equivalent to the actual tariff differential collected by the Philippines for year 2003 and 2004 on eleven petrochemical products exported from Singapore to the Philippines. This information is obtained from the Ministry of Trade and Industry of Singapore.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

V. THE ASEAN INVESTMENT AREA (AIA)

A. Objective of AIA

The AIA Framework Agreement was signed on 7 October 1998 with its declared intent as follows: 'Together with the AFTA programme, the AIA will give investors, existing and new, a framework highly conducive to regional integrated production activities, procurement, manufacturing and resources based investment activities.'

In tandem with the AIA, ASEAN implemented the ASEAN Industrial Cooperation Scheme (AICO) on 1 November 1996 to replace previous schemes of economic cooperation. This scheme was intended to provide leverage upon the vertically integrated multi-national enterprises that used ASEAN as a production platform.

B. The ASEAN Industrial Cooperation Scheme (AICO)

An AICO arrangement is a cooperative arrangement consisting of a minimum of two participating companies from two different countries. The output of the arrangement (referred to as an 'approved AICO product')[33] will immediately enjoy preferential tariff rates of 0–5 per cent, and have unlimited access into the markets of the participating countries.[34] As of 10 March 2003, 104 AICO projects have been approved.[35] Not surprisingly, the majority are in the automotive sector, with a handful in the electrical and electronic and food processing sectors. The majority of the participants are Japanese automotive and electronic firms like Toyota, Honda, and Sony.

The major drawback of the AICO scheme is that the AICO final products do not have unlimited access at preferential tariff rates to the *whole* of ASEAN. They have unlimited access at preferential rates to the *participating* countries only. Similarly, AICO intermediate parts and components or raw materials may only be imported and used as inputs in the manufacture of the approved AICO final products in a particular AICO arrangement. Such a schizophrenic mindset will stymie deeper integration within ASEAN as investors are not allowed to integrate their production networks across ASEAN and sell their products in the ASEAN market as a whole. This further shows that the ASEAN countries are not yet comfortable with the idea of opening up unlimited access to their markets.

[33] An approved AICO product may be in the form of finished products, intermediate parts and components, or raw materials. AICO finished products have unlimited access into the markets of the participating countries but not AICO intermediate products or AICO raw materials. The latter products may only be imported and used as inputs in the manufacture of the approved final product in a particular AICO arrangement.

[34] Basic Agreement on the ASEAN Industrial Cooperation Scheme can be obtained from the ASEAN Secretariat website at <http://www.aseansec.org/economic/eco_aico.htm>.

[35] ASEAN Annual Report, 2002–2003 above n 27, at 28.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

Nevertheless the AICO scheme has fared a shade better than its predecessors. It has attracted substantial 'outsourcing or efficiency-seeking' type of foreign direct investment (FDI) from Japan in the automobile and electronic sector. In fact South-East Asia is increasingly regarded by Japanese investors as a single economic space, particularly in the electronic sector.[36] National equity requirements in manufacturing investments in most ASEAN countries have been abolished since 1 January 2003, and this signals the further openness in the investment climate in ASEAN. [37]

VI. A THEORETICAL EVALUATION OF ASEAN INTEGRATION

A. Some Definitions and Theories

The main purpose of ASEAN economic integration through AFTA was to

> [h]elp enhance the competitiveness of the region for production geared towards the global market through tariff reduction and elimination of non-tariff barriers. All these measures are aimed primarily at generating greater efficiency and effectiveness for the conduct of business transactions in the region. The purpose of AFTA is to enhance production efficiency, cost effectiveness and promote trade and investment in a manner consistent with GATT principles and rules.[38]

It would be easier to understand the meaning of AFTA's raison d'etre if we put it into a theoretical framework.

Tinbergen (1954) made a distinction between positive and negative integration. *Negative integration* denotes the removal of discrimination in national economic rules and policies under joint surveillance. *Positive integration* refers to the transfer to common institutions, or the joint exercise, of at least some powers. In practice, negative and positive integration may go together.

Another classical theory propounded by Balassa (1961) uses a stage approach to evaluate economic integration. Balassa's five stages of economic integration are as follows:[39]

[36] The parts and component trade in Asia is staggering. For example, more than 40 per cent of Japan's trade in Asia is trade in parts rather than trade in final products. In the machinery trade sector, East-Asian intra-regional trade as a whole shot up 92 per cent in finished goods from 1990 to 1998, but 179 per cent for parts. The share of intra-ASEAN parts trade rose from 67 per cent to 84 per cent in the same period, see speeches of BG(NS) George Yeo, Singapore Minister for Trade and Industry and Hiroyuki Kato, President Director of JETRO Jakarta at the AFTA 2002 SYPOSIUM, 31 Jan 2002, Jakarta. Copies of the speeches can be found at <http://www.aseansec.org/view.asp?file=/newdata/george_yeo.htm> and <http://www.aseansec.org/print.asp?file=/newdata/jetro.htm>.

[37] ASEAN Annual Report above n 27 at 23.

[38] ASEAN Economic Into-View (A quarterly bulletin of the Bureau of Economic Co-operation, ASEAN Secretariat) 2, no 1 (Sept 1994), 10.

[39] J Pelkmans 'European Integration, Methods and Economic Analysis' *New York Financial Times* 2001 7-9.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

Free trade area—tariffs and quotas are eliminated within members of the integration, but members retain national tariffs (and quotas) against third countries. No positive integration here.[40]

Customs union—no discrimination among members in products markets, with a common external tariff structure against non-members. No positive integration is present.

Common market—a customs union that abolishes restrictions in factor movements. No positive integration here.

Economic union—a common market that practises some degree of harmonization of national economic policies in order to remove the discrimination that results from the disparity in these policies. Positive integration is introduced here.

Total economic integration—there is a unification of monetary, fiscal, special, and counter cyclical policies amongst members. A supranational authority is set up where decisions are binding on the Member States. A vision of a centralist and unitary state is contemplated here.

Others like Robert Z Lawrence (1995) drew a distinction between *deeper* integration, that is, integration that moves beyond the removal of border barriers, and *shallow* integration, which is trade liberalization.[41]

Economic analyses of free trade areas and customs union date back to Viner's seminal thesis on trade creation and trade diversion.[42] Building upon the theory of comparative advantage, Viner postulated that if tariff barriers are reduced, then members of a regional trading arrangement will displace higher cost domestic production with imports from a partner country. There will be gains, which Viner termed as trade creation. In contrast, if partner country production displaces cheaper imports from the rest of the world, that is welfare-reducing and it is called trade diversion. Thus regional trading arrangements, as the 'second-best' option after free trade, will only be welfare-enhancing if trade creation exceeds trade diversion.[43] Yet, to many non-economists, a contraction of domestic production (trade creation) is considered to be welfare-inhibiting, for it means a loss of jobs, while trade diversion may be considered as welfare-enhancing since domestic factors are being put back to work.[44] Viner's paradigm has been criticized and modified

[40] Balassa's stage approach can be quite easily fitted within the wider analysis of Tinbergen's positive and negative dichotomy.

[41] RZ Lawrence *Regionalism, Multilateralism, and deeper Integration* (Washington DC The Brookings Institution 1995) 7–8. Further see C Prima Braga 'Comments on the Proliferation of Regional Integration Arrangements' (1996) 27 Law and Policy in International Business 963–4.

[42] J Viner *The Customs Union Issue* (London Stevens 1950) ch IV.

[43] AJ Venables 'International Trade: Regional Economic Integration' prepared for the *International Encyclopaedia of Social and Behavourial Sciences* (Amsterdam, New York Elsevier 2001).

[44] MG Plummer 'The ASEAN Free-Trade Area: Backwards or Forwards' Centre for ASEAN Studies Discussion Paper No 5 (1996).

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

by several leading academics such as Meade (1955) and Lipsey (1960), but it is beyond the scope of this paper to analyse these critiques.[45]

Having found small or even negative predicted static effects from Viner's paradigm, advocates of regional trading arrangements extol its 'dynamic' effects. These typically hypothesize that regional integration increases the rate of growth and capital accumulation, brings about increases in investment domestically and globally, economies of scale, and technological change. Brada and Mendez (1988) argued that the creation of an enlarged market reduces the risk and raises the expected return to an investment project by enabling firms to lower costs through economies of scale, by providing a larger pool of consumers with heterogeneous tastes, and by benefiting from factor mobility and the ability to regionalize their operations. Risks of changes in trade partner's commercial policies are reduced as the integration scheme gives credence and 'locks in' the partner's domestic reforms.[46]

Venables (2000) argued that regional integration could also foster increased competition between firms which may induce firms to eliminate internal inefficiencies (so-called X-inefficiency) and raise productivity. Since competition raises the probability of bankruptcy and layoffs, it also generates stronger incentives for workers to improve productivity, and increases labour turnover across firms within sectors.[47]

Puga and Venables (1996) used techniques from the study of economic geography to show that regional integration may promote industrial development in southern economies. The unilateral liberalization of the imports of manufactures by a southern country promotes the development of local industry by lowering the cost of imported intermediates. With improved access to a northern market, gains from north–south integration are likely to be greater than gains from south-south integration. In addition, if the southern markets are small, the smaller would be the degree of industrialization and the later it would take place. But there is little evidence of these effects.[48]

Finally, what is the impact of a regional arrangement on the location of FDI? Roughly speaking, FDI may be of the horizontal variety or the vertical. The effects that regional arrangements can have on FDI depend on the motive of FDI. As regards intra-regional FDI, if it is the horizontal 'tariff-jumping' variety, then reducing tariff levels would discourage FDI among members. In

[45] The following economists have critiqued and expanded work on Viner's paradigm: J Meade *The Theory of Customs Unions* (Amsterdam NorthHolland 1955); Gehrels 'Customs Unions From a Single Country Viewpoint' (1950–7) 24 Review of Economic Studies 61–4; Lipsey 'The Theory of Customs Unions: A General Survey' (1960) 70 The Economic Journal 496–513; Cooper and Massell 'A New Look At Customs Union Theory' (1965) 75 Economic Journal 742–7; and Wonnacott and Wonnacott 'Is Unilateral Tariff Reduction Preferable to a Customs Union?' (1981) 71 American Economic Review 704–14.

[46] JC Brada and JA Mendez 'An Estimate of the Dynamic Effects of Economic Integration' (1988) The Review of Economics and Statistics 163–8.

[47] Venables above n 43 at 7 and Plummer above n 44 at 12.

[48] D Puga and AJ Venables 'Trading Arrangements and Industrial Development' Centre for Economic Performance, Discussion Paper No 319 (1996).

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

the absence of trade costs, firms would trade rather than establish plants in another country. If FDI is of the vertical variety, the firm produces goods in the labour-abundant country for both markets. In this case, FDI and trade are complements. The enlargement of the market brought about by a regional arrangement may also induce FDI from extra-regional sources to take advantage of the extended market and economies of scale. But within the regional arrangement there may be winners and losers. The increased FDI flow may not be evenly distributed among all the members. As long as other costs remain, firms will locate according to plant-level economies and other factors such as a FDI-friendly host country. Thus it has been argued that in a regional arrangement, medium-sized countries are the worst hit, since small countries would have been supplied by trade unless their trade barriers are very high.[49]

B. Theoretical Evaluation of ASEAN Economic Integration

Bearing AFTA's raison d'être in mind, it is contended that it would not be appropriate to assess ASEAN economic integration using Balassa's stages approach because, unlike the EU, ASEAN leaders lacked the political will to advance beyond a free trade area. In addition, ASEAN leaders put national policies over and above regionalism despite recent talks of forming a common market in 2020. For example, there would be difficulty even in obtaining the consensus to form a customs union unless the common external tariff rates are no different from the preferential rates. Obviously this is difficult to achieve because the average ASEAN6 tariffs range from 0.1 per cent for Singapore to 43.2 per cent for Thailand. Singapore, being an entrepôt trade hub, is completely dependent on the world markets, so that even fairly reasonable common tariffs would have ruined its duty free markets.[50] Conversely, very low common external tariffs, which would be in harmony with the concept of open regionalism, would have been unacceptable to the other ASEAN members.[51] In essence, a customs union would entail a surrender of the members' sovereignty over their external tariffs against non-members and a sharing of revenue. This kind of supra-national decision-making is incompatible with the ASEAN psyche. In fact, representatives from the ASEAN Secretariat in a roundtable discussion on the ASEAN Economic Community drove home the point that the ASEAN leaders have specifically eschewed the creation of any supra-national body.[52]

[49] E Levy Yeyati, E Stein, and C Daude 'Regional Integration and the Location of FDI' Inter-American Development Bank et al Working Paper No 492 (2003).

[50] Palmujoki above n 17, at 53.

[51] There would be strong objections from the newer members such as Cambodia who derived 56 per cent of its tax revenue from customs duties, see E Fukase and W Martin 'Free Trade Area Membership as a Stepping Stone to Development: The Case of ASEAN' World Bank Discussion Paper No 421, The World Bank, Washington DC.

[52] The ASEAN Community Roundtable on 'Towards Realising An ASEAN Community' hosted by the Institute of South-East Asian Studies and held on 4–5 June 2004, which this author was invited to attend as an observer.

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Obviously ASEAN integration will not progress to Balassa's fifth stage, ie the creation of a supra-national authority. ASEAN leaders will never surrender national sovereignty for a 'fortress Europe' type of regionalism. ASEAN will never be inward-looking. Each individual ASEAN country has had strong trade and investment ties with the OECD countries for three decades. They looked to these extra-ASEAN partners for trade and investment. In turn, the multinational corporations from these countries had brought with them advanced technology and capital which had propelled and supported the strong economic growth of the ASEAN countries until the 1997 Asian financial crisis. This entrenched behaviour will not change in the near future. Robert Lawrence's approach of deep and shallow integration is a purely academic study that will not guide us as to the future direction of ASEAN integration. More importantly, deeper integration does not mean better or more efficient integration.[53] A key assumption in the traditional trade theories of Balassa and Tinbergen is the presence of a political will to integrate beyond a free trade area regardless of its costs. This key assumption is starkly absent in the ASEAN integration equation.

Turning now to economic analyses, it is contended that measuring the static effects of Viner's paradigm in ASEAN will provide some help towards predicting the future direction of ASEAN economic integration. If there are economic gains, the ASEAN leaders would certainly be more open to the idea of liberalizing and integrating their economies. In a simulation study by DeRosa (1998), it was found that trade diversion from the major industrial countries ranges from US$107 million to US$234 million whilst the expansion of intra-ASEAN trade ranges from US$1 billion to US$2.9 billion. In other words, AFTA is net trade-creating.[54] It was found that Singapore and Malaysia, being more open economies, became the beneficiaries of preferential trade liberalization under AFTA (trade diversion), but the welfare gains from AFTA were relatively modest.[55] More importantly, the authors found that a MFN liberalization of ASEAN trade relations with the world would result in a total expansion of ASEAN trade which is three times greater than under the AFTA plan.[56]

In addition, can AFTA help ASEAN achieve the 'dynamic' effects? In a simulation study by Emiko Fukase and Winters (2003), it was found that in Laos, regional integration appears to be followed by a notable re-orientation of imports towards ASEAN suppliers, particularly in respect of equipment supplied by the ASEAN 4 countries. There was no such trade diversion

[53] Plummer above n 44 at 9 and 32–3.

[54] DA De Rosa 'Regional Trading Arrangements Among Developing Countries: The ASEAN Example' Research Report 103, International Food Policy Research Institute, Washington DC (1998).

[55] But in a study conducted by Soloaga and Winters (1996), it was found that there was little evidence of trade diversion in AFTA between the period from 1980 to 1996, see Trade Blocs, A World Bank Policy Research Report (2000) at 49.

[56] Fukase and Martin above n 51 at 70.

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observed in Vietnam, although over 1 per cent of its GDP is spent on capital goods imports from its ASEAN neighbours. It was argued by the authors that such trade diversion may be harmful as it would reduce total factor productivity growth in Vietnam in the long-term if AFTA shifts imports from sources with higher stocks of knowledge towards ASEAN sources which have lower stocks of knowledge. It was, however, counter-argued that although the ASEAN countries may not be innovating countries, it is likely that they have assimilated the technology of the OECD and newly industrializing economies (NIE) countries through trade and FDI and that at least part of that assimilated knowledge is passed on in their exports. Furthermore, a large proportion of intra-ASEAN trade is conducted by trans-national firms in vertically integrated models so that technology would have been assimilated in the process. But the authors found that the quantification of Vietnam's total factor productivity growth would not be reliable based on the data collected.[57]

The above analyses indicate that ASEAN economic integration is about achieving the 'dynamic effects' of regional integration. But measuring the 'dynamic' effects of regional integration can prove elusive. Proper empirical studies have yet to be conducted to measure the 'dynamic' effects of ASEAN economic integration. But as indicated above, the welfare gains from MFN liberalization are three times that of AFTA. 'Open regionalism' is therefore the way forward for ASEAN economic integration. The ASEAN leaders see AFTA as a training ground toward broader liberalization and eventual integration with the global economy, rather than as a goal in itself.

VII. OBSTACLES TO DEEPER ECONOMIC INTEGRATION

A. Sacred Cows

National sovereignty and non-interference are the twin pillars of ASEAN integration. ASEAN declarations and treaties are usually vague and too general to set practical rules of cooperation. In typical ASEAN fashion, the ASEAN leaders at the Bali Concord II failed to define what an 'ASEAN common market' would mean, leaving the ASEAN Secretariat clueless as to how to implement the protocols signed at the summit. The notion of *bhinneka tunggal ika*, 'unity in diversity' shapes general principles and informal decision-making patterns, and justifies the independence of the members within the organization. In ASEAN cooperation, behavioural norms, rather than formal rules and regulations, occupy central position. ASEAN regionalism encompasses creating common norms and basing decision-making on *mushawarah* (consultation) and *mufakat* (consensus) rather than building supra-national structures. The founding documents define ASEAN activities

[57] E Fukase and LA Winters 'Possible Dynamic Effects of AFTA for the New Member Countries' 26 The World Economy No 4 (2003) 853–71.

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as State-led, not the product of any formal and permanent decision-making ASEAN institutions.[58]

In addition, a central aim of the strengthening national and ASEAN resilience is to develop awareness in third countries of an ASEAN regional identity. This identity building was achieved by promoting the harmonization of views, coordinating positions and, where possible and desirable, taking common action.[59] For instance, ASEAN negotiators in the Uruguay Round supported one another by taking their counterparts' side even though they did not have an interest in that issue. This collaboration among members showed unity and strengthened the negotiation position for each individual member.[60]

But this sacred cow has stymied closer and deeper integration in ASEAN for three decades.

B. Lack of Supra-national Bodies and Community Law

Despite three decades of close cooperation, ASEAN still lacks a supra-national decision-making or law-making organ for legislating community law, or for the enforcement of any ASEAN protocol or resolution of disputes. ASEAN leaders have repeatedly rejected the idea of supra-nationality. It may be argued that this is the Achilles' heels of ASEAN integration. One writer has posited that the mere existence of supra-national institutions that are legally and organically independent of national bureaucracies would advance regional economic integration. To the extent that the legal rules created or enforced by supra-national organs become more precise, even-handed, predictable, and reliable, the rules will gain in international acceptance and legitimacy. As a result, the public's opprobrium following non-enforcement will increase and sovereign action or inaction aimed at barring their effectiveness will become less legitimate.[61] Unfortunately, ASEAN integration efforts are far from attaining this ideal. It has yet to develop what can be called 'ASEAN Law', ie community law that is truly supra-national.

In the first ASEAN investment arbitration, which took place in January 2003, the arbitration tribunal eschewed the opportunity to pave the way for developing ASEAN law. Instead they decided that they had no jurisdiction to hear the dispute on very technical grounds. The facts were that on 29 November 1993, one Yaung Chi Oo Trading Pte Ltd, a Singapore incorporated company (the Singapore Party) signed a joint venture agreement with a Myanmar State agency (the Myanmar Party), for the operation of a beer factory in Myanmar. Under the agreement, the Myanmar party was to contribute machinery and land for the use of the beer factory in Mandalay, while the Singapore party was to contribute specified amounts of capital

[58] Palmujoki above n 17 at 8 and 36.
[59] Ibid.
[60] N Thongpakde above n 8 at 67.
[61] HA Grigera Naon 'Sovereignty and Regionalism' (1996) 27 Law and Policy in International Business 1073, 1080–1.

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within 3 years, as well as marketing expertise and foreign raw materials etc. The Myanmar party held 55 per cent of the shares in the joint venture company whilst the Singapore party held 45 per cent of the shares. The term of the agreement was 5 years with provision for renewal for another 5 years, subject to the approval of the Myanmar Foreign Investment Commission. At the conclusion of the joint venture agreement, Myanmar was not a member of ASEAN. In 1997, Myanmar became a member of the ASEAN grouping. By the latter part of 1997, problems occurred in the relationship between the joint venture partners. The Singapore party claimed that between 17 December 1997 and 12 January 1998, armed agents of the Myanmar Government (the respondents) seized the Mandalay factory. Further seizure occurred on 11 November 1998, and certain bank accounts of the Singapore party and its managing director and principal shareholder were frozen. On 24 December 1999, the joint venture company was wound up by the Yangon Divisional Court, despite opposition from the Singapore party. Negotiations failed to resolve the dispute and on 29 June 2000, the Singapore party commenced arbitration proceedings against the Myanmar Government for wrongful expropriation of the beer factory at Mandalay. The arbitration proceedings were purportedly brought under the aegis of the 1987 ASEAN Treaty for Promotion and Protection of Investments (1987 Treaty).

The sole issue was whether the Singapore party had made an investment in Myanmar that was protected under the 1987 Treaty. If so, then the Singapore party could initiate arbitration under Article X thereof, and the arbitration tribunal would have jurisdiction to hear the case.

Article II of the 1987 Treaty classifies investments into two categories. Article II(1) applies to investments made *after* a contracting party accedes to the Treaty (ie future investments) and Article II(3) which applies to existing investments. The tribunal noted that there is an express requirement of approval in writing and registration of a foreign investment if it is to be protected by the 1987 Treaty. As regards future investments, the tribunal decided that no special procedure is required for separate approval and registration in order for the party to enjoy protection, as long as the host government's foreign investment agency had approved the investment. But as regards existing investments, the tribunal decided that under Article II(3), an express written approval and registration of the investment was needed in order for the investment to be protected under the Treaty. This was so even though the contracting parties to the 1987 Treaty did not create any special process or registration machinery for investments to be approved and registered.

The tribunal's decision on this point is perplexing. In the first place, none of the contracting parties to the 1987 Treaty has in place any special process or procedure for approval and registration of investments under the Treaty except for Singapore. This is because foreign investments can be made freely in Singapore without any requirement of approval or registration. If no special approval and registration is required for so-called 'future' investments, then

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the same reasoning should also apply to existing investments. The plain language of Article II(1) and (3) does not seem to suggest that a different and separate process of approval and registration is contemplated for existing investments. But the tribunal took a literal reading of Article II(3) and held otherwise. It is contended that such technicalities can be easily remedied by the ASEAN Secretariat through the creation of a registry for intra-ASEAN investments.

The Singapore Party next argued that the more liberal definitions and concepts of Articles 1 and 2 of the AIA are themselves 'better and enhanced provisions' which will apply through Article 12, AIA.[62] In other words, the Singapore Party was arguing that Articles 1 and 2, AIA, which do not require investments to be specially approved and registered before they are covered by the AIA, are 'better and enhanced provisions', so that investments need not be specially approved and registered to be protected under the 1987 Treaty. But the tribunal rejected this argument and decided that the AIA and the 1987 Treaty are agreements that are intended to operate separately. Thus in relation to any investment which is covered by both agreements, the investor is entitled to the benefit of both and thus of the most beneficial treatment afforded by either. Article 12(1), AIA should not be interpreted as applying *de novo* the provisions of the 1987 Treaty, including Article X thereof. It is contended that such a decision clearly goes against the spirit of according fair and equitable treatment, and full protection of investments under the 1987 Treaty, as well as frustrating the intent behind the AIA to create a predictable investment regime in ASEAN and realize a more liberal and transparent investment environment.

Lastly, the Singapore Party argued that arbitral jurisdiction could be conferred on the Tribunal on the basis of the MFN clause contained in Article 8, AIA, read in conjunction with the bilateral investment treaty between Myanmar and the Philippines concluded on 17 February 1998. But the Tribunal also rejected this argument and held that if the Singapore Party had wanted to rely on this route, they should have done so at the time of instituting the arbitral proceedings. In any event, the Tribunal held that there was not to be found any arbitral jurisdiction in any bilateral investment treaty that Myanmar had signed at the relevant time. The grounds for such a decision were not entirely clear. Clearly, the first ever ASEAN investment dispute arbitration is a non-starter that sends a 'chilling effect' to investors in the region.

Now why is it difficult to develop community law in ASEAN? Firstly, the ASEAN countries are not only competitors for trade and investments, but their political history also shows the envy and antagonism that has existed between some of the Member States, particularly between Singapore and Malaysia.[63]

[62] Art 12(1), AIA provides that Member States affirm their existing rights and obligations under the 1987 ASEAN Agreement for the Promotion and Protection of Investments and its 1996 Protocol. In the event that this Agreement provides for better or enhanced provisions over the said Agreement and its Protocol, then such provisions of this Agreement shall prevail.

[63] *The Straits Times* 17 May 2002, H2. There are many areas of contention between Singapore and Malaysia even in the pre-independence days. They range from serious concerns like the

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Difficulties in the political arena were historically resolved through diplomatic channels rather than 'hard' legal processes. And the result is that the political sensitivities among the ASEAN countries effectively prevented the development of community law in ASEAN.

Secondly, the legal systems of the Member States differ greatly, ranging from the common law to civil law systems, and hybrids of both.[64] If ASEAN were to formulate a legal regime, the community rules have to be 'neutral' in nature to avoid impinging upon the cultural sensitivities of the Member States. Past experience suggests that ASEAN will likely rely on the *mushawarah* and *mufakat* principle to reach agreement on the delicate issues of harmonizing the ASEAN members' national laws into a regional system that respects cultural sensitivities and national sovereignty.[65] The Protocol of Dispute Settlement Mechanism 1996 further vindicates this contention that ASEAN regionalism will be based on cooperation and its dispute settlement mechanism will find solutions based on conciliation, mediation and dependable offices, rather than the use of 'hard' legal mechanisms such as an ASEAN Court of Justice or ASEAN Parliament.

C. 1997 Asian Financial Crisis: Lack of Community Instrument to Combat Crisis

The lack of a supra-national body or regional instruments to combat the crisis was pointedly felt by the ASEAN leaders. Despite that, the ASEAN leaders stuck to the old ASEAN way of national resilience and non-interference. They proposed two instruments to deal with the crisis. The first was to promote intra-ASEAN trade so that there would be less dependence on the expensive dollar-based trade. But this effort did not take off as the statistics showed that intra-ASEAN trade remained fairly constant at an average of 23.7 per cent of total bloc trade before and after the crisis. In fact there was even a slight reduction in intra-ASEAN trade after 1997.[66]

The second proposal was to establish a separate US$50 billion Asian fund to be independent of control by the IMF and its big donors.[67] The proposed fund was scuttled by strong opposition from the IMF and the US. After some

'water issue', 'tudung issue' and the reclamation works carried out by Singapore around Pulau Tekong and Tuas, which Malaysia alleged violated their territorial sovereignty, to even trivial matters that Singapore was buying fewer tomatoes from Malaysia.

[64] Haas above n 3 at 857–63. Common law forms the basis for the legal systems of Brunei, Malaysia, and Singapore, while Spanish and US laws significantly influence the Philippines' legal system. Indonesia, on the other hand, follows the construct of the Dutch legal system, and Thailand's legal system derives from an amalgamation of the continental and common law structures.

[65] Haas above n 3 at 863.

[66] World Development Indicators, World Bank, 2002.

[67] The IMF aid package to Indonesia and Malaysia was rejected as their governments perceived that the measures impinged upon their national sovereignty, see Palmujoki above n 17 at 135.

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horse-trading, the ASEAN leaders opted for a more modest plan, which was to establish a watchdog mechanism to better monitor the financial development of the ASEAN countries. Two new institutions were instituted. They are the ASEAN Surveillance Coordinating Unit and the ASEAN Surveillance Technical Support Unit,[68] whose tasks are to keep track of the macroeconomic trends in the ASEAN plus three countries and provide early detection and warning of any adverse development in these countries. It also inaugurated a peer review system where ASEAN leaders constantly exchange views and information to safeguard against future crisis.[69]

These regional measures were chosen because they least impinge upon the national sovereignty of the ASEAN countries. Similarly, ASEAN could not assist in the East Timor debacle as a regional bloc because of sensitivities among some members, particularly the new members, that intervention would set a precedent for interference into the domestic affairs of member countries.[70] The crises that plagued the region in 1997–8 clearly showed the fault-lines of ASEAN integration. ASEAN was rendered impotent as a bloc and the 'ASEAN Way' of national sovereignty and non-interference prevented the member countries from coming together to assist the troubled countries of Indonesia, Malaysia, and Thailand. Any aid that was given came from international bodies like the IMF or from bilateral assistance by individual ASEAN countries such as Singapore, who provided a US$1 billion in co-financing for Thailand and pledged a US$5 billion aid package to Indonesia.

VIII. WHY ASEAN WILL NOT PROGRESS BEYOND A FREE TRADE AREA

A. AFTA's raison d'être

A simple comparison of trade figures with regional trade blocs such as NAFTA would show that AFTA has not prompted any marked increase in intra-ASEAN trade (23.08 per cent between 1995 and 2000),[71] unlike NAFTA which showed a jump of about 71.5 per cent in intra-NAFTA trade in the same period.[72] This is confirmed by the studies referred to above that though AFTA is net trade-creating, the impact on intra-ASEAN trade is not significant.

[68] Palmujoki above n 17 at 135–7.

[69] The ASEAN plus 3 refers to the ASEAN countries and Japan, China, and South Korea. For a detailed account of the early warning system, see ADB Asia Economic Monitor (2002) at 24. The URL address is <http://www.aric.adb.org>.

[70] S Pitsuwan *Future Directions for ASEAN* (Singapore Institute of Southeast Asian Studies 2001).

[71] In absolute figures, intra-ASEAN trade grew at an average annual rate of 18.29 per cent between 1993 (US$44.2 billion) and 2000 (US$100.8 billion). But the extra-ASEAN rate was also growing on par and hence, the intra-ASEAN trade had remained fairly constant despite AFTA, see World Development Indicators, The World Bank (2002).

[72] Since the establishment of NAFTA, total trade and investment between Canada, Mexico, and the US have steadily increased each year. Canada's merchandise trade with the US reached

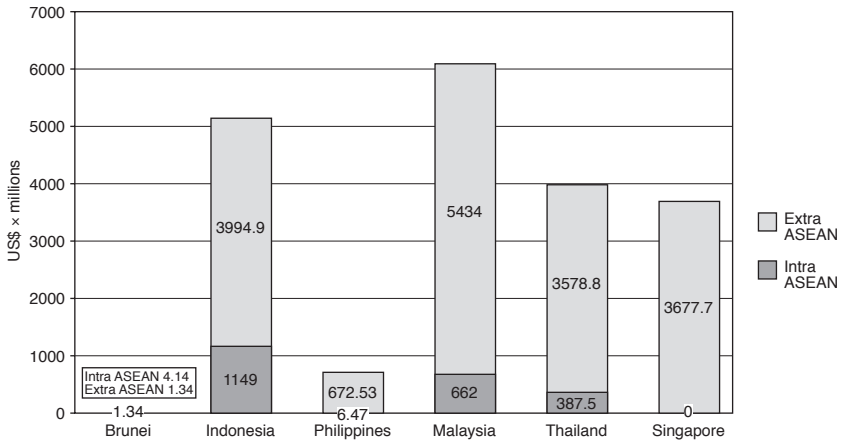
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But the ASEAN leaders are not too bothered with this because the raison d'etre of AFTA was to promote FDI in ASEAN, both from within and outside of ASEAN. Has AFTA succeeded on this score?

B. AFTA's Impact on Intra-ASEAN FDI

Diagram 1 and 2 indicate the FDI inflow and percentages of intra-ASEAN and extra-ASEAN FDI to the manufacturing sector of the ASEAN 6 countries in 2001 respectively. It is a tried fact that extra-ASEAN FDI far exceeds intra-ASEAN FDI in the last two decades because of the strong external ties that the ASEAN6 countries had with the OECD countries, who are their major trade and investment partners. Diagram 3 summarizes the intra-ASEAN and extra-ASEAN FDI flow to the manufacturing sector in 1992 and 2001 and shows that intra-ASEAN FDI for the ASEAN 6 countries have not increased significantly despite AFTA.

Diagram 4 shows the growth rates for intra-ASEAN FDI and extra-ASEAN FDI from 1991 to 2001. Did AFTA induce any increase in intra-ASEAN investments? Apart from 1994 where intra-ASEAN investments grew by an astounding 446 per cent, intra-ASEAN investment generally grew at an average rate of 3.9 per cent between 1991 and 2001. It is submitted that AFTA did

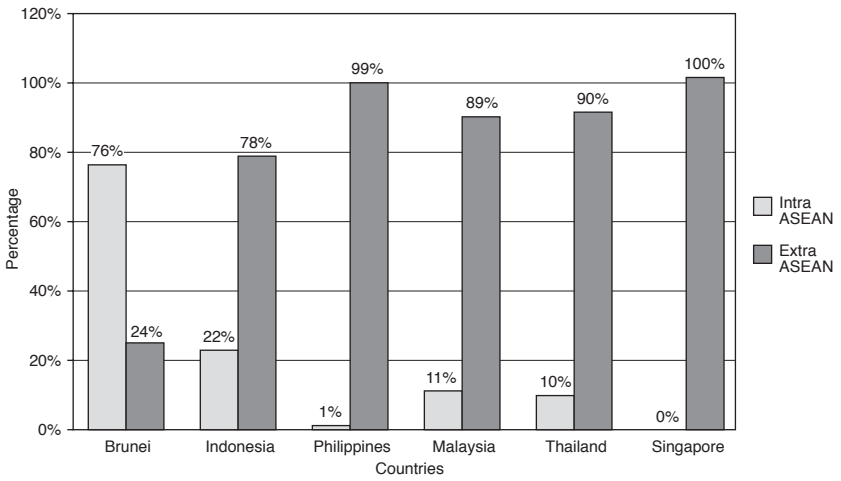


Source: ASEAN Secretariat

Diagram 1: FDI Inflow to Manufacturing Sector of ASEAN 6: Intra ASEAN vs Extra ASEAN, 2001

US$588.7 billion in 2000. Two-way merchandise trade between Canada and Mexico has doubled since 1994 to reach US$14.1 billion in 2000. In terms of Canada's merchandise exports, 86.6 per cent went to the NAFTA partners, see Department of Foreign Affairs and International Trade (2001) <http://www.dfait-maeci.gc.ca/nafta-alena/over-e.asp>.

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Source: ASEAN Secretariat

Diagram 2: FDI Inflow to Manufacturing Sector of ASEAN 6, 2001 (%)

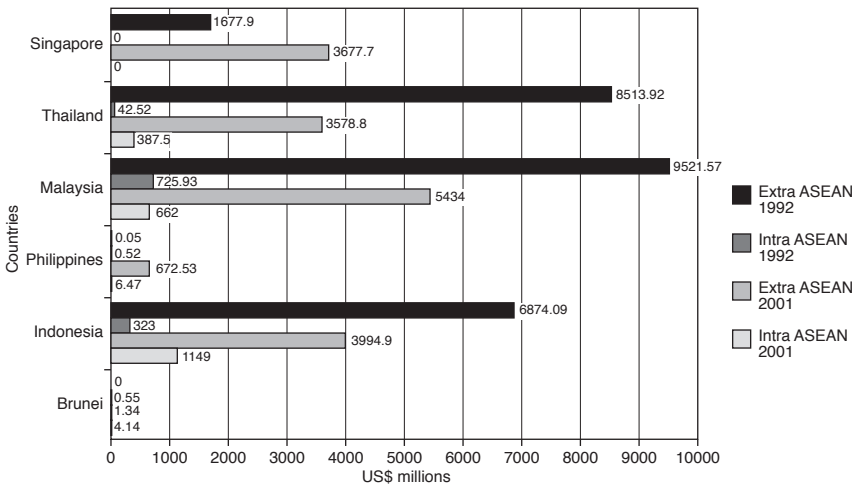
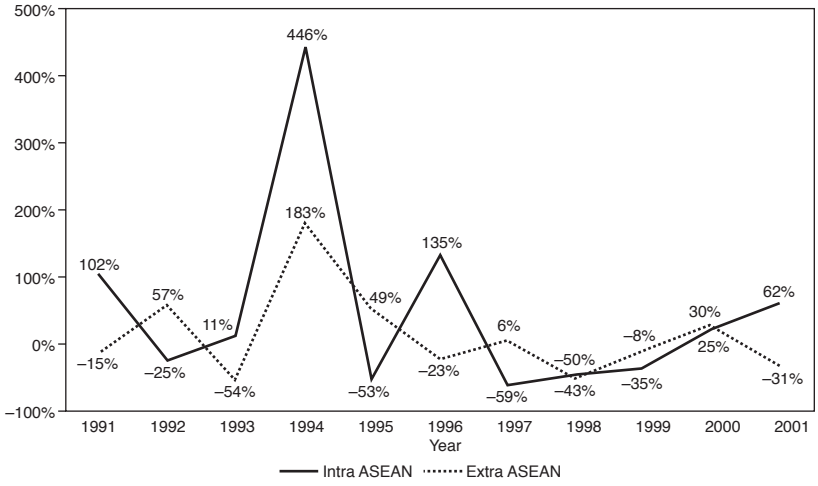


Diagram 3: FDI Inflow to the Manufacturing Sector of ASEAN 6, 1992 and 2001

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Source: ASEAN Secretariat

Diagram 4: Growth Rate for FDI Inflow to the Manufacturing Sector of ASEAN: Intra ASEAN vs Extra ASEAN

not cause the surge in intra-ASEAN FDI in 1994 for two reasons. Firstly, the rate of annual reduction of tariffs under AFTA was only 1.02 per cent.[73] This reduction rate was too small to make any impact, and it would be too soon for AFTA (which was implemented in 1992) to induce the astounding increase in 1994. Secondly, it is clear from Table 1 that the chief reason for the upsurge in intra-ASEAN FDI in 1994 was the huge influx of investments from Singapore, whose government was at that time aggressively promoting its 'regionalization policy'.[74] Of the VLMC countries, only Myanmar experienced an increase in intra-ASEAN FDI whilst the rest suffered declines in intra-ASEAN FDI. Diagram 3 further shows that since the 1997 financial crisis, intra-ASEAN FDI has dropped significantly despite big cuts in tariffs implemented under AFTA. Even after the AIA was implemented in 1998, intra-ASEAN FDI did not increase significantly, and the increase of 25 per cent in 2000 and 62 per cent in 2001 were caused by the general recovery in the region rather than by AFTA or the AIA. Quite clearly, AFTA has not fulfilled its goal to increase intra-ASEAN investment.

It is contended that the major reason for AIA's lacklustre performance is because it does not accord better or more favourable treatment to ASEAN

[73] ASEAN Secretariat Trade Report <http://www.aseansec.org/economic/ov_trd.htm>.

[74] A Kawada 'Current Situation and Outlook for Economic and Technical Co-operation among Developing Countries in APEC: Singapore Co-operation Toward Neighbouring Asian Developing Countries' IDE APEC Study Centre Working Paper Series 97/98-No 3.

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Table 1: Intra-ASEAN FDI to the Manufacturing Sector, 1993–4 (US$)

	1993	1994	% Increase/(Decrease)	Reason
Brunei	20,490,184	3,345,294	(84%)	Malaysia reduced its investment by 85 per cent
Indonesia	250,950,000	5,526,150,000	2,102%	Singapore increased its investment by 2,470 per cent
Philippines	8,372,087	431,752,584	5,057%	Malaysia increased its investment by 4,041 per cent and Singapore increased its investment by 1,569 per cent
Malaysia	735,759,065	10,222,967,085	1,289%	Singapore increased its investment by 61 per cent and investment by joint countries increased by 50 per cent
Thailand	45,669,300	116,207,555	154%	Singapore increased its investment by 951 per cent and Malaysia increased its investment by 67 per cent
Singapore	Not Available (NA)	NA	NA	NA
Vietnam	416,615,000	241,269,000	(42%)	Malaysia reduced its investment by 84 per cent
Laos	40,500,104	1 6,145,798	(60%)	Thailand reduced its investment by 60 per cent
Myanmar	12,672,000	24,954,000	97%	Malaysia increased its investment by 821 per cent
Cambodia	NA	NA	NA	NA

investors. Under the AIA, an 'ASEAN investor' is immediately accorded national and MFN treatment in respect of any investment in a member country. An 'ASEAN investor' is defined as either (a) a national of a Member State; or (b) any juridical person of a Member State, making an investment in another Member State, the effective ASEAN equity of which taken cumulatively with all other ASEAN equities fulfils at least the minimum percentage required to meet the national equity requirements and other equity requirements of domestic laws and published national policies, if any, of the host country in respect of that investment.

An 'effective ASEAN equity' in respect of an investment in an ASEAN Member State means ultimate holdings by nationals or juridical persons of ASEAN Member States in that investment. A 'juridical person' means any legal entity duly constituted or otherwise organised under applicable law of a Member State, whether for profit or otherwise, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, joint venture, sole proprietorship, or association. A 'national' means a natural person having the citizenship of a Member State in accordance with its applicable laws.

In other words, a Singapore incorporated company wholly owned by Singapore nationals (ie an indigenous ASEAN company) would qualify as an ASEAN investor if it wants to invest in Malaysia, as it meets the 60 per cent local equity requirement. So would a subsidiary of a foreign multinational incorporated in Singapore, which is at least 60 per cent owned by Singaporean nationals.[75] Thus a subsidiary of a foreign multinational incorporated in an ASEAN country has the same status as an indigenous ASEAN company.[76] There is no preference given to an indigenous ASEAN investor. Since the indigenous ASEAN investor competes on equal terms with non-ASEAN investors, it is contended that the AIA would not directly effect an increase in intra-ASEAN investments by indigenous ASEAN investors.

The next question is whether the AIA will spur an increase in intra-ASEAN investments by ASEAN subsidiaries of foreign multinationals. There is no data available on the profile of intra-ASEAN investors, so it is difficult to answer this question. But it has been suggested that the Japanese may take advantage of this scheme to expand their regional production platforms throughout ASEAN, as they did under the AICO scheme.[77] In any case, there

[75] L Thanadsillapakul 'Open Regionalism and deeper Integration: The Implementation of ASEAN Investment Area (AIA) and ASEAN Free Trade Area (AFTA)'<http://www.dundee.ac.uk/cepmlp/journal/html/article6-16a.html> at 16-17.

[76] I have used the term 'indigenous ASEAN investor or company' to mean companies that are incorporated locally and wholly owned by nationals of the ASEAN countries. Note that a wholly-owned subsidiary of a foreign multinational corporation would not qualify as an ASEAN investor as it would not meet the ASEAN equity requirement.

[77] Studies by the Japanese EXIM bank, JETRO, the Nomura Research Institute, and the Economist Intelligent Unit on AFTA and AICO support the view that more firms, especially Japanese firms, are undertaking investment strategies or regional operation activities built around

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are conceivably two reasons why a foreign investor would wish to access an ASEAN country using a local subsidiary incorporated in another ASEAN country: when they need to circumvent some local laws that are particularly stringent, or when they need to relocate to cheaper host countries within ASEAN.[78] Other than that, it is difficult to see why a foreign investor would not directly invest in any ASEAN country.

Not according better treatment to ASEAN investors is a deliberate act on the part of ASEAN to embrace open regionalism. The AIA is not intended to be inward-looking and exclusive, but to facilitate investments from third countries into ASEAN. Attracting intra-ASEAN FDI is a side goal. Hence, local subsidiaries of foreign multinationals are considered as 'ASEAN investors'. This is in sharp contrast to other regional arrangements like NAFTA and the EU which exercise regional exclusivity.[79] As such, it would not be accurate to consider the AIA agreement as a regional integration agreement in the traditional sense. This would make the AIA a travesty of economic integration. Instead it is a collaborative effort amongst the ASEAN countries to promote ASEAN as an investment platform, whilst unilaterally opening up and liberalizing their trade and industries.[80]

At present, the ASEAN countries maintain their own investment boards to approve investments according to their respective domestic laws. Some of these domestic laws are more restrictive than others; for instance, Malaysia requires foreign investors to partner *bumiputera* (ethnic Malays) in certain kinds of investment. But such a system can now be circumvented by a foreign

the various regional arrangements. These firms capitalize on AFTA and AICO by establishing multiple plants which are strategically located across ASEAN, each with specific integrated products functions to produce parts, components, and finished products that allow optimal integrated operation processes, see the ASEAN Investment Report (1999) at 46.

[78] Ibid.

[79] Under NAFTA, a Member State may deny access to an investor of another Member State if the investor is owned or controlled by investors from a non-Member State, and the denying Member State does not maintain diplomatic relations with the non-Member State; or adopts or maintains measures with respect to the non-Member State that prohibit transactions with the investor. Alternatively, a NAFTA Member State may deny access to an investor from a Member State that is owned or controlled by an investor from a non-Member State, if the first mentioned investor does not carry on a substantial business activity in the territory of that Member State. In contrast, the AIA has gone the other way and permitted investors owned by non-ASEAN members to access and invest in ASEAN. A copy of the NAFTA agreement can be obtained from <http://www.sice.oas.org/trade/nafta/chap-111.asp>.

[80] Under this mandate, the ASEAN Coordinating Committee on Investment had conducted joint investment missions to major cities in the US and Japan. The private sectors from both host and source countries have been actively wooed to participate in these programmes, and information has been disseminated to the public through the ASEAN Supporting Industry database and various publications. Detailed discussions on the ASEAN Coordinating Committee's work to implement the AIA can be found in the ASEAN Investment Report (2000). The ASEAN Supporting Industry database contains more than 11,000 entries of parts and component manufacturers and is a valuable resource that investors can tap into. In addition, the Committee has organized regional training workshops for the VLMC countries to help them implement the AIA in their respective countries as well as coordinate the publication of numerous reports on FDI in ASEAN.

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investor establishing a subsidiary with local partners in a country that has a more open investment legal framework like Singapore,[81] and then claiming national and MFN treatment in another ASEAN country through the 'ASEAN investor' mechanism described above. Does it still make sense to have multiple domestic investment agencies to oversee and approve foreign investments? It is therefore recommended that the ASEAN countries should band together to set up a central agency comprising senior civil servants from the ASEAN countries to approve investments in ASEAN in order to level the playing field. But this may require surrendering some sovereign powers to this agency, an idea that would undoubtedly be balked at by the ASEAN leaders at this stage.

C. AFTA's Impact on Extra-ASEAN FDI

Diagram 3 clearly shows that extra-ASEAN FDI has declined significantly since the 1997 financial crisis, despite the Hanoi Plan of Action to accelerate AFTA by 5 years. The theory that regional integration would spur 'vertically integrated' FDI is not quite borne out by the ASEAN experience, although there is some evidence that AFTA and AICO have attracted 'vertically integrated' FDI from Japanese multinationals.[82] What the above analyses show is that the ASEAN countries have not integrated or pulled closer together in view of the low levels of intra-ASEAN FDI. Instead they have continued their strategy of integrating closer with extra-ASEAN countries, particularly the OECD countries, despite AFTA and the AIA. This signals that ASEAN is unlikely to integrate deeper as a bloc and the force of integration will likely be centrifugal in nature.

IX. THE ROAD AHEAD

A. Urgent Need to Progress Beyond a Free Trade Area: The China Factor

Empirical studies on FDI inflows into ASEAN have confirmed that they are of the 'outsourcing or efficiency-seeking' variety,[83] especially FDI from Japanese investors.[84] In other words, the Japanese invested in ASEAN to capi-

[81] Note that unlike the NAFTA agreement, the subsidiary does not even need to prove that it has a substantial business in Singapore.

[82] F Yun-Keung Kwan and LD Qiu 'The ASEAN+3 Trading Bloc' Working Paper Series No 198, City University of Hong Kong (2003). In this study, the authors used direct econometric evidence to show that integration among ASEAN countries has led to increased FDI inflows from Japan. In fact, compared with the rest of the world, an ASEAN member will receive an additional 3 per cent increase in Japanese FDI inflows per one percentage point increase in openness.

[83] The other types of FDI are the 'trade-barrier circumventing' or 'tariff-jumping' FDI, 'market and technology accessing or market-seeking' FDI and 'round-tripping' FDI. A discussion on them can be found in K Fukushima and CH Kwan 'Foreign Direct Investment and Regional Industrial Restructuring in Asia' in *The New Wave of Foreign Direct Investment in Asia* (Singapore Institute of South-East Asian Studies 1995) 3, 8–10.

[84] These studies include VN Balasubramanyan and D Greenaway 'Regional Integration Agreements and Foreign Direct Investment' in K Anderson and R Blackhurst *Regional*

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

talize on the locational advantages that the ASEAN countries could offer in terms of a cost-effective export production base with abundant low cost labour and other factors.[85]

But ASEAN is fast losing its edge as a cost-efficient centre for 'vertically integrated production' networks. China is the preferred destination for FDI inflows into Asia because of its low labour cost and huge domestic market, although Japanese investors are beginning to have some reservations about China.[86] Between 1989 and 1994, ASEAN and China received about the same amount of FDI inflows into Asia. But by 2001, the tides have turned, and China received far more FDI inflows into Asia than ASEAN. The exact figures will be shocking to many. In 2001, China received US$46,846 million of FDI inflows into Asia, while ASEAN received only US$13,241 million.[87] In other words, the flow of FDI into ASEAN is only a third of the amount flowing into China, and this trend appears set to continue. It is an alarming situation!

How can ASEAN stem this deluge of FDI into China? First, ASEAN has to integrate beyond a free trade area. It has to form a common market with zero tariffs and a free movement of goods and services. It has to band together to form a single market huge enough to attract investors to invest in ASEAN for the purpose of not only producing there but also to sell there as well. In other words, ASEAN has to attract the 'market-seeking' variety of FDI. This may appear far-fetched to many ASEAN observers. But it found support with the Singapore Prime Minister Goh Chok Tong, who floated this idea at an ASEAN summit. Thailand concurred with Mr Goh.[88] In fact, the ASEAN Vision 2020 aspires to such an idea.[89]

Integration and the Global Trading System (New York Harvester Wheatsheaf 1993) 147–66; K Fukushima and CH Kwan above n 82 at 3–39; and S Urata 'Japanese Foreign Direct Investment in Asia' in N Kumar et al *Globalization, Foreign Direct Investment and Technology Transfers* (London and New York The United Nations University INTECH 1998) 146–73.

[85] For instance, Mitsubishi Corporation launched a brand-to-brand complementation scheme which involved a regional division of labour amongst Malaysia, Thailand, and the Philippines. Malaysia concentrated on the production of door panels and other stamped parts, Thailand specialized in the manufacture of fuel tanks, consoles, bumpers and windshields, while the Philippines focused on the production of transmission parts, see P-C Athukorala and J Meno above n 22, at 81.

[86] But after the initial euphoria of investing in China, foreign investors are reviewing their China strategy. A survey released by the Japan External Trade Organization (JETRO) found that Japanese automakers will stay put in ASEAN even in the face of intense competition from China because they need to balance against a possible failure of their Chinese operations, see *The Straits Times* 1 Mar 2003. The recent episode on the severe acute respiratory syndrome pandemic that swept across major cities in China such as Beijing and Guangdong serves as a warning to investors against putting all their eggs in the 'China' basket.

[87] Statistics of Foreign Direct Investment in ASEAN, Comprehensive Data Set (2002).

[88] *The Straits Times* 5 Nov 2002. A study commissioned by the ASEAN leaders has found that the costs of doing business in ASEAN had become 'unnecessarily high', not to mention the differing product standards and customs red tape that have prevented companies from achieving economies of scale across the region. The study concluded that ASEAN's competitiveness has been seriously eroded and the grouping has failed to capitalize on its strengths.

[89] A copy of the Declaration can be obtained from <http://iir.nccu.edu.tw/cscap/page_4c/documents/aseanvision2020.h>. The Declaration, inter alia, called for the creation of a stable, prosperous, and highly competitive ASEAN economic region in which there is a free flow of goods,

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On 7 October 2003 the ASEAN leaders gave impetus to such an idea by signing the Bali Concord II to realize the vision of an ASEAN common market by 2020. But the leaders failed to make its meaning clear, or perhaps deliberately left it unclear. A schedule of commitments was laid down under which AFTA will be advanced further by achieving zero tariffs; the removal of red tape and faster customs clearance by 2004 for seven priority sectors; push for the liberalization of health-care, air-travel and electronic commerce sectors by 2010; allow visa-free travel for all ASEAN nationals by 2005, and a common visa for international travellers; and establish an impartial panel for the speedy resolution of business problems and disputes between member countries.[90]

But current problems may stymie the realization of this vision. First, political differences between some ASEAN countries: Singapore and Malaysia had had a troubled past during their early days of independence, which has caused acrimony up to the present day.[91] Border disputes also occur between Thailand and Cambodia.[92]

Secondly, intense competition exists amongst the ASEAN countries, particularly in the services sector. Thailand and Malaysia have taken steps to develop their media, health and education sectors for competition against Singapore.[93] Malaysia and Singapore have competed intensely in the sea-air cargo business.[94] Such beggar-thy-neighbour tactics do not auger well for deeper economic integration in ASEAN. In the end, national resilience will cause the ASEAN leaders to safeguard their domestic economies and protect jobs first instead of pushing ahead with ASEAN integration. Thirdly, non-tariff barriers to trade and investment in the ASEAN countries are likely to remain high in the foreseeable future.[95]

Lastly, domestic politics and economic concerns could slow down the implementation of the ASEAN economic community. Indonesia, for instance,

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

[90] *The Straits Times* 8 Oct 2003.

[91] Ibid 17 May 2002.

[92] In January 2003, skirmishes between the Thai and Cambodian governments over insensitive remarks made by a popular Thai actress sparked off rioters who attacked the Thai embassy in Cambodia. A month later, Cambodia closed its borders with Thailand to protest against the unequal trade ties between the two countries, see *The Straits Times* 7 Feb 2002 and 7 Mar 2003.

[93] It should be noted that these sectors are not included under the ASEAN Framework Agreement for Services as they have also been excluded under the General Agreement for Trade in Services. Thus governments are free to impose whatever restrictions they want to protect these sectors.

[94] *The Straits Times* 24 Jan 2003. Malaysia has ambitious plans to compete with Singapore in the sea-air transshipment business. It has built the Tanjung Pelapas Port which drew two of Singapore's largest clients (Mearsk and Evergreen) to use its facilities there. It hopes to build another port at Kuantan to intercept transshipment cargo en-route to Singapore.

[95] A copy of a report on the barriers to trade and investment in the ASEAN countries can be found at <http://www.jmcti.org/mondai/e-country/amalay.html et al>. For instance, Malaysia and Thailand link the foreign equity ratio to exports; in the Philippines, foreign ownership has to be reduced below 40 per cent within 30 years; and in Vietnam, regulations mandate that the foreign investor source for local parts in order to enjoy preferential tariff rates.

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is worried that lower tariffs will hurt its competitiveness both regionally and globally, not to mention that the lowering of tariffs in the automotive and agricultural sectors may also cause a flood of cheaper regional imports into Indonesia leading to electoral pressures. Complications have also arisen over the US's 3-year ban on imports from Myanmar in response to human rights abuses and the detention of the political activist, Aung San Suu Kyi. Economic sanctions aimed at one member may affect the others if the target country tries to re-route its exports through the common market.[96] Even Singapore, which is the juggernaut in the formation of the ASEAN common market, would face serious problems accepting a free flow of labour.[97]

Despite these obstacles, the ASEAN leaders have forged ahead with closer economic cooperation through the formation of various protocols on Standards and Quality, mutual recognition, and an ASEAN Harmonized Tariff Nomenclature.[98] But it must be reiterated that these efforts do not signal a deeper economic integration within ASEAN. They are efforts taken to facilitate the flow of goods within ASEAN so as to further AFTA's goals of achieving the 'dynamic' effects of regional integration and attracting more FDI from extra-regional sources.

B. A Hub-and-Spoke Strategy or a 'Spaghetti-Bowl' of Free Trade Agreements?

Since its inception, ASEAN has maintained dialogue with many extra-ASEAN countries, notably its major trade and investment partners such as the US, the EU, and Japan. Recently, the number of dialogue partners has increased to embrace the middle powers such as China, South Korea, India, Australia, and New Zealand. ASEAN strives to be a hub for businesses coming to Asia and hopes to connect itself with the world's major trading powers via free trade agreements forming a hub-and-spoke arrangement. But can it really do so?

The hard economic data speaks otherwise. In 2000, ASEAN-10's exports only comprised 6.8 per cent of world merchandise exports, compared to NAFTA's 19.5 per cent and the EU's 37 per cent, respectively. Similarly, ASEAN-10's imports only comprised 5.6 per cent of world merchandise imports compared to NAFTA's 25.8 per cent and the EU's 36.9 per cent, respectively.[99] Although the US and the EU are ASEAN's major trade partners (in 2001, ASEAN exported 16.9 per cent and 15.2 per cent of its total

[96] The Economist Intelligence Unit–Executive Briefing. A copy can be obtained at <www.http://global.factiva.com/en/arch/display.asp>.

[97] *Business Times* Singapore 17 Sept 2003.

[98] Copies of ASEAN reports on standards conformity, mutual recognition arrangements, and customs cooperation can be found at <http://www.aseansec.org/8091.htm>, <http://www.aseansec.org/14308.htm>, and <http://www.aseansec.org/14382.htm>.

[99] World Trade Organization, International Trade Statistics, 2003.

https://doi.org/10.1093/iclq/53.4.935 Published online by Cambridge University Press

exports to the US and EU respectively), these exports only comprised a very small portion of US and EU trade. The US's exports to the ASEAN 6 (excluding Brunei) only comprised 5.9 per cent of total US exports. Similarly, the EU's exports to the ASEAN countries, namely Malaysia and Singapore, only comprised 0.8 per cent of the EU's total exports.[100]

In terms of FDI stock, only about 4 per cent of the US's global FDI stock is invested in ASEAN, despite the US being a major investor of ASEAN. Similarly, less than two per cent of the EU's FDI stock of 888.5 billion euros from 1992 to 1998 was invested in ASEAN.[101] Much as ASEAN would like to engage the US and EU in its economic development, the reality is that ASEAN is not quite on the US and EU's radar screen. The US is more interested in forging the free trade agreement for the Americas; likewise the EU is more involved in engaging their Eastern European neighbours. For geopolitical reasons and the propensity of the US and EU to link trade issues with human rights protection and political conditions, it is hard to imagine that these superpowers would agree to form a free trade agreement with ASEAN as a bloc.[102]

Thus ASEAN is better off looking for partners in the region. There will not be a hub-and-spoke of free trade agreements with ASEAN acting as a hub. Neither will intra-ASEAN integration deepen. Even the VLMC countries have forged closer economic cooperation with extra-ASEAN partners than intra-ASEAN partners, as shown in Table 2.

Instead ASEAN will forge closer economic integration and cooperation with its regional neighbours, creating a 'spaghetti-bowl' effect of free trade agreements traversing the region. In December 1998, President Kim Dae-jung of South Korea proposed the creation of the East Asia Vision Group and East

Table 2: FDI Inflows to VLMC countries, 1992, 1995, 1999, and 2001

Percentage (%)	1992		1995		1999		2001	
	Intra	Extra	Intra	Extra	Intra	Extra	Intra	Extra
Vietnam	3	97	15	85	21	79	8	92
Laos	26	74	39	61	9	91	23	77
Myanmar	–	–	85	15	19	81	22	78
Cambodia	–	–	46	54	4	94	4	96

Source: ASEAN Secretariat

[100] World Trade Organization, International Trade Statistics, 2003.
[101] ASEAN Investment Report, 1999.
[102] In the published speech of Surin Pitsuwan, a former Foreign Minister of Thailand, His Excellency recalled that there was great difficulty in forging the ASEAN–EU alliance because the EU was not comfortable with the inclusion of some of the newer members of ASEAN for political reasons, see n 70.

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Asia Study Group to explore the feasibility of the ASEAN plus 3 (ie China, Japan, and South Korea) economic bloc. Though this vision appears to be a resuscitation of the East Asia Economic Caucus concept proposed by Dr Mahathir, the ex-Prime Minister of Malaysia a decade ago, it is however enjoying better reception than its predecessor. China gave impetus to this vision by signing a free trade pact with ASEAN at the Bali Concord II to achieve a free trade area by 2010 for the ASEAN 6 countries and 2015 for the VLMC countries. Japan, fearing being marginalized by these two blocs, has also signed an agreement for closer economic partnership with ASEAN at the same meeting. Economically, the ASEAN plus 3 trading bloc appears to gravitate towards the north-south integration paradigm, which, according to Puga and Venables, will bring about the development of local industry in the southern economies through the lowering of costs of imported intermediates. In addition, like the US in NAFTA, Japan as the second largest economy in the world can form a ready market for ASEAN's final products. However, thus far ASEAN's negotiations with Japan, China and South Korea have not been conducted as a composite bloc but individually with each of the 'plus 3 countries'.

The strategic implication of the ASEAN plus 3 bloc is complex. There is a lack of what is termed the 'nucleus', like the German-France axis in the EU and the 'nucleus' role played by the US in NAFTA. Due to the historical baggage emanating from the Second World War, China and South Korea will not tolerate a dominant role for Japan in the region. To China, Japan is America's mouth-piece in Asia, and the free trade pact with ASEAN is part of China's policy to dilute US unilateralism in Asia. Japan is also not too keen to play a pivotal role in the ASEAN plus 3 bloc as its future and long-term goals are tied in with the multilateral GATT arrangement rather than an East Asian integrated bloc or bilateral free trade agreements with regional countries. Japan's concerns are with the Western powers, and she will not sacrifice her alliance with the US to enhance and protect the interests of East Asian countries. Can ASEAN play the 'nucleus' role in this stratagem? Although an ASEAN nucleus may be more palatable to the US, it is submitted that ASEAN has neither the intention nor the capacity to take on this task.[103]

At the age of 30, ASEAN is neither an economic community nor a political community. It has become a diplomatic community, but this too has been weakening in the recent past. Today, ASEAN has lost its diplomatic clout. At its height in 1994, ASEAN was able to engage its major dialogue partners to form the ASEAN Regional Forum (ARF) in the building of confidence-building measures for the region. Yet the process appears to have been bogged down in protracted confidence-building measures and has failed to show signs of progress towards preventive diplomacy and conflict resolution. Preventive

[103] L Sheng *China-ASEAN Free Trade Area: Origins, Developments and Strategic Motivations* (Singapore Institute of Southeast Asian Studies 2003).

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diplomacy requires openness to 'comments' from other member countries, which most ASEAN members are not prepared to accept at this moment. The lack of political will to deepen political cooperation has taken the lustre off the ARF, and unless ASEAN can reinvigorate the ARF, it will also cease to be a diplomatic community.[104]

In the final analysis, ASEAN will amble along forging free trade agreements with regional partners, but it will be like a ship sailing in the ocean without a rudder. Without the firm political will to create enduring institutions and processes to guide and implement its regional integration programme, ASEAN will be like the proverbial Jews wandering in the desert for 40 years and not knowing in which direction they would go.

X. CONCLUSION

ASEAN economic integration is not about creating any supranational bodies with executive, legislative or judicial functions. The ASEAN leaders have no intention to create a 'fortress ASEAN'. ASEAN economic integration aims to sharpen ASEAN's competitive edge as a production base geared for the world market. Together with AFTA, the AIA and AICO are intended to give investors a highly conducive framework for regional integrated production activities, procurement, manufacturing, and resource-based investment activities. As such, ASEAN can only embrace open regionalism and will not be a closed bloc.

Until the Bali Concord II, the ASEAN leaders have no political will to integrate beyond a free trade area. But the Bali Concord II appears to map out a different course for ASEAN economic integration. It called for an ASEAN economic community. It is contended that the old paradigm has not changed because the ASEAN economic community envisioned by the ASEAN leaders is quite different from the EU-style supra-national community. It will be 'free trade-plus', ie it will be a common market with a free flow of goods, services and investments *to facilitate the flow of FDI* into ASEAN. It will not be the EU-style economic union. [105]

The devil is in implementing the reforms. Rodolfo Severino, the former Secretary-General of ASEAN, reported that there is little real integration despite the relative success of AFTA in respect of the ASEAN 6 countries and the many framework agreements, work programmes and master plans which ASEAN has initiated.[106] The AICO scheme serves as an example of the reluc-

[104] SCS Tay et al *A New ASEAN in a New Millennium* (Singapore Institute of International Affairs and Centre for Strategic and International Studies Jakarta 2003) 226.

[105] 'The Future of ASEAN' a speech by HE Ong Keng Yong, Secretary-General of ASEAN in Singapore, 22 Mar 2003. A copy can be obtained from the ASEAN Secretariat website at <http://www.aseansec.org/14690.htm>.

[106] *The Straits Times* 15 Sept 2003.

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tance of the ASEAN leaders to open up their domestic markets. It will be a long way off to a single market. The proposed establishment of an independent tribunal to adjudicate trade and economic disputes is in its nascent stages, and its success is anyone's guess.

It is my prediction that within ASEAN, national resilience and non-interference will continue to stymie deeper economic integration as ASEAN governments guard their sovereignty jealously. And this is difficult to understand given that the ASEAN 6 countries were willing to surrender some sovereignty when they acceded to the WTO. They are, however, not willing to do the same for ASEAN. The VLMC countries will remain closed economies because of the need to protect their domestic industries. The ASEAN 6 countries may initially spur ahead with integration under the leadership of the new Secretary-General, Ong Keng Yong, who is a Singaporean. Singapore and Thailand are very keen to develop an ASEAN economic community, but they will be dragged down by the other ASEAN members. In the final analysis, the political tit-for-tat and intense competition which exist between some ASEAN countries such as Singapore and Malaysia will obstruct bloc integration in ASEAN. It is difficult to see ASEAN as a common market in 2020.

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