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ASEAN: Escaping from a shallow integration

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The economic growth of East Asia has outperformed the world's growth for the last 2 decades[1]. The emerging Southeast Asia economies: Indonesia, Malaysia, the Philippines, Thailand and Viet Nam had an average annual growth of 5.2%.

East Asia has achieved such high economic growth by applying development strategies which have aggressively exploited the mechanics of global value chains, and Southeast Asian economies, through ASEAN, were forward-thinking on this. ASEAN undertook two bold reforms. The first was the ASEAN Free Trade Area or AFTA, established in 1992, before the WTO. This foundation enabled ASEAN to become a regional production base in East Asia. The second was the ASEAN Trade in Goods Agreement or ATIGA and the ASEAN Comprehensive Investment Agreement or ACIA, both established in 2009. ATIGA outlines a schedule on tariff elimination; and ACIA covers protection, liberalisation, facilitation and promotion. ACIA basically says that ASEAN agrees to open 6 sectors: Agriculture, Mining, Fishery, Forestry, Manufacturing, Services to Manufacturing. ACIA also outlines a negative list of investment in those sectors. The review is regularly updated. This is designed to improve transparency on foreign equity caps in ASEAN.

As a results of these reforms, exports of machinery and parts contributed more than 43% of exports of goods in major ASEAN countries in 2015. Based on trade in value added, Asia accounts for more than 50% of the world's automobile production, 62% of liquid display screens, 86% of smartphones and 100% of digital cameras. Much of the production in Southeast Asia, and East Asia overall, is based on production networks.

The main challenge for ASEAN now is that ASEAN could be trapped in a 'shallow integration'.

Intra-ASEAN trade increased merely from 22% in 2000 to 24% in 2015. After close to 70 years of trade liberalisation, a series of recent events suggests that the tide may well be turning. First, international trade as a proportion of global gross domestic product has stopped growing in the last decade. Second, momentum for trade liberalisation at the multilateral level has stumbled with the failure of the Doha round, with limited hope for revival. Even regional trade agreements, sometimes seen as alternatives to multilateral liberalisation, are under heavy attack. Last, while the global financial crisis in 2008–2009 did not lead to the explosion of protectionism feared by many, the use of temporary trade measures by emerging countries has been markedly rising (Didier et al., 2016)[2], including in Southeast Asia.

Two underlying drivers of ASEAN's shallow integration.

The first is Rules of Origin (ROOs). Rules of Origin set the production location requirements for exporters if they want to enjoy preferential tariff rates. The tariff equivalent of ASEAN's ROOs is 3.4% which is reasonably low compared with the tariff equivalent of OECD's ROOs of around 4-5%. But ASEAN's ROOs are still perceived to be complicated by many businesses; and the tariff equivalent of ASEAN's ROOs is still relatively high in certain sectors: 13% in footwear, 9% in leather products, 8% in apparel and 7% in prepared food (Cadot and Ing, 2015)[3].

The second factor that can cause a shallow integration in ASEAN is Non-Tariff Measures (NTMs). NTMs are defined in general as policy measures, other than tariffs, that can affect price or quantity or both of international trade (UNCTAD, 2013)[4]. While many NTMs stem from non-trade policy objectives (i.e. health, safety or environmental protection), they can also be used as instruments of commercial policy; even NTMs pursuing legitimate, non-trade objectives may have restrictive or distortionary effects on international trade.

While the average tariff rates of the 10 ASEAN countries declined from 8.9% in 2000 to 4.5% in 2015, the number of NTMs increased from 1,634 to 5,975 measures over the same period. 29% of total measures are sanitary and phytosanitary SPS, 43% are technical barrier to trade TBT, 16% are export measures and 12% are in other measures (Ing, et. al., 2016)[5].

In a volatile international political context, the converging trends should be taken seriously.

For Rules of Origin, ASEAN should adopt more business friendly Rules of Origins, and generalise an alternate rules of origins of Regional Value Content or Change in Tariff Heading (RVC and CTH) as about 40% of ROOs in the AFTA and ASEAN+1 FTAs are in the form of RVC-40 and CTH. This means that an exporter could claim for preferential tariff rates if it could fulfill the requirement that the exported product is comprises at least 40% value added produced by the members of an FTA; or there are such processes in the member countries that cause a change in tariff classification heading of a product.

For NTMs, the solution is not to try – yet again – to negotiate down NTMs, but rather to take the issue back to the country level and to embed it in a drive for better regulations. As the WTOs static (rules-based) disciplines may not prove sufficient to ensure that regulations correctly balance regulatory demands against economic efficiency, we argue that dynamic disciplines should be put in place in the form of quality control on regulatory processes. First, good regulations should pass a basic test of economic rationality, i.e. set correct incentives from a societal point of view. This would weed out most of the regulations pushed by special interests against the common good. Second, they should fully internalise externalities between different areas of government intervention, trade-related or not; for instance, the productivity gain expected should be balanced against its environmental cost. Third, to start with, ASEAN and its trading partners should improve their transparency on NTMs.

Institutionally, the quality-control systems we advocate would take the form of regulatory supervision bodies or a National Economic Council (NEC), possibly building on a national committee set up, with strong in-house analytical capabilities and the power to review and screen all existing and proposed regulations to manage overall Rules of Origins (ROOs), Non-Tariff Measures (NTMs), and to some extent to also include issues across in-line ministries such as Free Trade Agreements (FTAs), One integrated system of investment approval, and One integrated system customs clearance.

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1 The views expressed here are the authors' personal views

2 Didier, T., M.A. Kose, F. Ohnsorge, and L.S. Ye (2016), 'Slowdown in Emerging Markets: Rough Patch or Prolonged Weakness?', CEPR Discussion Paper 11065, London: Centre for Economic Policy Research.

3 Cadot, O., and Ing, L.Y (2015), 'How Restrictive are ASEAN's ROOs?', Asian Economic Papers, Fall 2016, Vol. 15, No. 3, Pages 115-134.

4 UNCTAD (2013), Classification of Non-Tariff Measures February 2012 Version, New York and Geneva: UNCTAD.

5 Ing, L. Y., O. Cadot, R. Anandhika and S. Urata (2016), Non-Tariff Measures in ASEAN: A Simple Proposal, in Ing, L.Y., S. F. de Cordoba and. O. Cadot (eds.), Non-Tariff Measures in ASEAN. ERIA Research Project Report 2015-1, Jakarta: ERIA, pp.13-36.