

***THE DEVASTATING CRISIS, SINGAPORE'S EXTRA-ASEAN
FREE TRADE AGREEMENTS AND THEIR IMPLICATIONS
FOR ASEAN***

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**Jose L. Tongzon
National University of Singapore**

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Postal address: P.O. Box 6501, S-113 83 Stockholm, Sweden. Office address: Sveavägen 65
Telephone: +46 8 736 93 60 Telefax: +46 8 31 30 17 E-mail: japan@hhs.se Internet:
<http://www.hhs.se/eijs>

The Devastating Crisis, Singapore's Extra-ASEAN Free Trade Agreements and their Implications for ASEAN *

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Jose L. Tongzon
Department of Economics
National University of Singapore
1 Arts Link, Singapore
Email: ecsjt@nus.edu.sg

Abstract

This paper aims to assess the implications of the Asian economic crisis of 1997/98 and Singapore's current initiatives to forge extra-ASEAN free trade agreements for the future of ASEAN economic integration. Have the recent crisis and the resulting economic difficulties undermined ASEAN's resolve to deepen their level of economic integration? Would Singapore's current initiatives at forging free trade deals with countries outside the region undermine the region's economic integration? The perception by some members in ASEAN that these bilateral free trade deals can be used as a "backdoor" entry into the ASEAN markets is particularly a matter of serious concern, which could threaten the very existence of ASEAN as a regional economic grouping.

It is argued that the recent crisis has instead galvanised ASEAN countries' determination to move forward in economic integration and on the basis of the most recent trends, there is strong indication that the political resolve is likely to be translated into concrete measures. However, there remain other more challenging tasks before the vision of a regional free trade can be realised. Further, the fear that Singapore's FTAs with other countries will undermine AFTA has not been based on concrete grounds. However, Singapore needs to assure other ASEAN members that Singapore is not abandoning ASEAN but remains committed to the success of AFTA with greater awareness of the political sensitivities of the other members.

Keywords: AFTA, bilateral free trade agreements, ASEAN, Asian crisis, implications

JEL: F15, F10

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The Devastating Crisis, Singapore's Extra-ASEAN Free Trade Agreements and their Implications for ASEAN

Perhaps there were two major developments since the inception of ASEAN Free Trade Area (AFTA) which have seriously tested the resolve of the ASEAN countries to bring this vision into reality: the recent economic crisis of 1997/1998 and Singapore's current foray into bilateral free trade agreements with non-ASEAN countries.

The crisis of 1997 and 1998 has significantly stalled the economic progress experienced by ASEAN countries and set back the economic and social gains they have achieved in the past decades. The tragic terrorist attacks of 11 September 2001 have further exacerbated their economic problems and dampened the outlook for greater trade liberalization within the framework of ASEAN Free Trade Area (AFTA). The recent initiatives by the Singapore government to forge bilateral free trade agreements (FTAs) with other countries outside ASEAN have also put further into question the future and effectiveness of ASEAN as a viable regional organization. The lack of a coordinated approach to the recent crisis and ineffectiveness to respond immediately to the crisis have already put into question the effectiveness of ASEAN as a rallying point. Against this backdrop, this paper will try to analyse whether the recent crisis has undermined ASEAN countries' resolve to push ahead with the AFTA vision and whether (or to what extent) Singapore's recent initiatives to form bilateral free trade agreements with other countries outside the region would undermine ASEAN's future economic integration.

1. The recent crisis and the future of AFTA

The recent crisis has had negative implications for the future of ASEAN co-operation. Trade liberalization entails short-term adjustment costs resulting from a reallocation of human resources consistent with the principle of comparative advantage. During the transition period workers that cannot re-equip themselves with the appropriate skills can find themselves structurally unemployed. In countries such as Indonesia and Thailand where unemployment and poverty have already risen from their pre-crisis levels due to the crisis, the costs of adjustments would become more severe and difficult.¹ Corollary to this is the issue of division of gains and costs. The crisis has reinforced the fear that trade liberalization would only benefit the more developed and competitive member countries at the expense of surrendering one's national priorities and autonomy in policy setting. For example, despite its recent official agreement to accelerate AFTA's implementation, there were indications that Vietnam's pace of implementation of its trade liberalization commitments has further slowed during and after the crisis. Vietnam's economic development strategy for 1999 emphasized agricultural development with domestic market orientation and importance of the state-owned enterprises (*The Economist*, 14-20 November 1998). This indication was confirmed by Vietnamese officials' admission that the regional crisis has slowed down their economic reforms and forced them to be more inward-looking (*Dow Jones International News*, 2 January 1999). Vietnam has not made any reference to their efforts to join the WTO or their commitment to tariff reductions until recently with the signing of the historic US-Vietnam bilateral trade accord and the impending membership of China in the WTO.

¹ There are also other concerns including Malaysia's refusal to include the motor vehicles industry in the liberalization under AFTA.

The crisis, by causing greater debt servicing commitments and exchange rate instability, has also accentuated the major concern that countries with higher levels of protection, such as Indonesia, the Philippines, Thailand and Vietnam, will have to give up more in terms of tariff revenue loss, current account deterioration and job losses than countries with lower levels of protection such as Singapore, Brunei and Malaysia. It has highlighted the question of mutuality of external trade and investment gains from AFTA. It has also intensified intra-ASEAN competition for non-ASEAN export markets and foreign investments, and could further raise this longstanding question of division of external gains among the ASEAN countries.

Despite these negative implications, the crisis seems to have strengthened their political will and resolve for closer economic integration. The crisis has invoked the ASEAN sense of ‘shared destiny’ and thus, reinforced their sense of determination to forge a greater level of economic co-operation; further, the contagion effect of the financial crisis has further demonstrated their high degree of economic inter-dependence, and therefore, highlighted the need for some policy co-ordination. It can be argued that the crisis has not at all derailed the implementation of their AFTA commitments. The progress made in meeting their AFTA commitment has been well on track. As Table 1 shows, in the area of Common Effective Preferential Tariff (CEPT) commitments, during the crisis the ASEAN6 countries (with the exception of Thailand) have agreed to commit themselves to reduce their average tariff rates to below 5 percent by 2001, ahead of the target year 2002.²

Moreover, they are now more committed to realize the vision of free trade amongst themselves by signing an agreement at the September 1999 ASEAN Economic Ministers Meeting in Singapore to adopt a target of zero tariffs to be achieved by 2015 for the six old members of ASEAN, and by 2018 for the four new ones (the transitional members of ASEAN).

Table 1. ASEAN6 Average CEPT Tariff Rates (% , 1997)*

Country	1996	1997	1998	1999	2000	2001	2002	2003
Brunei	1.58	1.58	1.21	1.16	0.90	0.87	0.87	0.84
Indonesia	9.05	8.53	7.05	5.82	4.92	4.61	4.20	3.72
Malaysia	4.62	4.04	3.41	3.01	2.58	2.41	2.27	1.97
Philippines	9.22	9.20	7.71	6.79	5.45	4.96	4.68	3.72
Singapore	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	14.41	13.10	10.46	9.65	7.29	7.27	5.93	4.63
ASEAN6	6.68	6.08	4.97	4.41	3.52	3.35	2.93	2.48

* All figures are mutually agreed tariff commitments, except for 1996 and 1997, which are actual CEPT tariff rates.

Source: ASEAN Secretariat (1997).

Apart from the deepening of tariff cuts, they have also resolved to expand further the commodity coverage of AFTA. After deciding to include the politically sensitive unprocessed agricultural products (UAPs) into the CEPT scheme, to be phased into the Inclusion List in five equal instalments, significant progress has been made since 1996. Out of a total of 1,995 UAP tariff lines, 1,358 tariff lines were phased into the Inclusion List in

² Under the Common Effective Preferential Tariffs (CEPT) scheme of AFTA, the ASEAN founding countries have agreed to reduce tariffs on all commodities traded within the member countries to between 0 and 5 per cent *ad valorem*, by the year 2002, except for a few commodities for national security reasons, protection of public morals, human, animal and plant life and health, and the protection of articles of artistic, historic or archaeological value. To avail of these preferences, the principle of reciprocity applies.

1996 and another 402 tariff lines were given TEL status to be phased into the CEPT scheme in seven equal instalments between 1997 and 2003.

Due to ASEAN efforts to review and shorten the General Exclusion List (GEL), some 230 tariff lines (29 percent) have been transferred out of the GEL into the Inclusion List at the 13th AFTA Council meeting in September 1999. Consequently, the Inclusion List now covers over 98 percent of all tariff lines for the ASEAN6 countries, as shown in Table 2.

Table 2. CEPT Product List, as of 1 January 2002: ASEAN6

Country	Inclusion List	Temporary Exclusion List	General Exclusion List	Sensitive List	Total
Brunei	6,276 (96.67)		202 (3.11)	14 (0.22)	6,492
Indonesia	7,213 (99.01)		68 (0.93)	4 (0.05)	7,285
Malaysia	10,039 (96.59)	218 (2.1)	53 (0.51)	83 (0.8)	10,393
Philippines	5,571 (98.79)	6 (0.11)	16 (0.28)	46 (0.82)	5,639
Singapore	5,859 (100.0)			5,859	5,859
Thailand	9,104 (99.92)			7 (0.08)	9,111
ASEAN6	44,062 (98.4)	224 (0.50)	339 (0.76)	154 (0.34)	44,779

Notes: The figures in brackets are percentage shares for the various categories.

Source: *ASEAN Secretariat* (2002)

Although the Inclusion Lists for the transitional member economies are not as large, they are still significant. Vietnam's Inclusion List has also expanded in absolute and proportional terms since her first submission of CEPT product list in 1996. See Table 3.

Table 3. CEPT Product List, as of 1 January 2002: Cambodia, Laos, Myanmar and Vietnam (CLMV)

Country	Inclusion List		Temporary Exclusion List		General Exclusion List		Sensitive List		Total	
	1996	2002	1996	2002	1996	2002	1996	2002	1996	2002
Cambodia		3,115 (45.66)		3,523 (51.64)		134 (1.96)		50 (0.74)		6,822
Laos		2,098 (59.08)		1,291 (36.36)		74 (2.08)		88 (2.48)		3,551
Myanmar		3,580 (65.42)		1,823 (33.32)		48 (0.88)		21 (0.38)		5,472
Vietnam	857 (38.64)	5,505 (86.14)	1,189 (53.61)	696 (10.89)	146 (2.28)	139 (2.18)	26 (5.47)	51 (0.79)	2,218	6,391
Total		14,298 (64.30)		7,333 (32.98)		395 (1.78)		210 (0.94)		22,236

Notes: Vietnam joined ASEAN in 1995, while Laos, Myanmar and Cambodia joined only quite recently; Figures in brackets are percentages.

Source: *ASEAN Secretariat* (1997 & 2002)

Some progress has also been made with regards to the inclusion of sensitive products. Some UAPs are classified as “sensitive” or “highly sensitive” which called for a special arrangement. At the 31st ASEAN Economic Ministers Meeting in October 1999 they have endorsed a Protocol on the Special Arrangement for Sensitive and Highly Sensitive Products which set out the mechanism for the integration of sensitive products into the CEPT scheme by 2010 with 0-5 percent tariff rates subject to no quantitative restrictions (QRs) or non-tariff barriers (NTBs). Rice was, however, exempted from this mechanism by allowing it to have an end-tariff of over 5 percent, but with no QRs or NTBs. Rice has always been a very difficult commodity to be liberalized due to the fact that each ASEAN member country, particularly Malaysia, Indonesia and the Philippines, would like to develop self-sufficiency in this commodity as a matter of economic and political security.

In most cases, unilateral tariff reductions have been undertaken with the assumption that even without reciprocity trade liberalization would be in their long-term economic interests. Moreover, the private industry sector, having realized the economic benefits of trade liberalisation in a sub-regional framework, has been pressuring their respect governments to expedite the process of trade liberalisation under AFTA.

The beginning of this year marked the target year for the final implementation of the ASEAN6 countries’ tariff reduction commitment to between 0 and 5 percent. By 1 January 2002, based on their respective Inclusion Lists as shown in Table 2, the following number of items did not have their duties reduced to 0-5%: 16 items (0.25%) of Brunei’s 2002 IL; 66 items (0.92%) of Indonesia’s 2002 IL; 922 items (9.2%) of Malaysia’s 2002 IL; 199 items (3.57%) of the Philippines’ 2002 IL; and 472 items (5.18%) of Thailand’s 2002 IL (ASEAN Secretariat, 2002). Please refer to Table 4 for more details.

Most of these temporarily excluded products are in the motor vehicles and parts (which were exempted from the 2002 deadline and given an extra-grace period of four years before its inclusion mainly due to the strong objection from Malaysia) and in the plastic and chemicals categories as suggested by Indonesia. As pointed out by the ASEAN Secretariat, the ASEAN6 member countries have always made clear that their objective for 2002 was to reduce the duties for the products in the Inclusion List to 0-5% with some flexibility allowed. If this is the case, then one can say that the ASEAN6 countries have successfully realised the first phase of regional economic integration.

There are, however, other remaining tasks in the second phase of the regional economic integration, which are more difficult to carry out. First, the non-tariff barriers that significantly exist in the region still need to be eliminated or harmonised. Second, there is a need to improve the institutional structure of ASEAN to make it more effective in rallying the individual members towards a co-ordinated stance or common action in dealing with future crises and in the implementation and enforcement of decisions. The long-standing principle of non-interference in the domestic affairs of other members and the principle of consensus have done well for the survival and development of ASEAN in the past, but has also been partly responsible for the slow progress in economic integration. The second phase is certainly more challenging than the first phase of trade liberalization. Surcharges, technical standards and customs procedures are the three most commonly used instruments of protection adopted by the ASEAN countries. Further, although there has been more differentiation in the commodities produced in these economies and thus creating more scope for greater complementarity within them, there are still significant differences between them, which could slow down the progress in economic integration. The crisis and the expansion of ASEAN to include the transitional economies of the region have certainly widened the level of diversity within ASEAN in terms of economic development, economic priorities and readiness towards economic liberalisation.

Table 4. **Implementation of Tariff Reduction Commitments, as of 1 January 2002**

Countries	Number of Tariff Items			Percentages		
	0-5%	>5%	Total	0-5%	>5%	Total
Brunei	6,260	16	6,276	99.75	0.25	100
Indonesia	7,147	66	7,213	99.08	0.92	100
Malaysia	9,117	922	10,039	90.82	9.18	100
Philippines	5,372	199	5,571	96.43	3.57	100
Singapore	5,859		5,859	100	0	100
Thailand	8,632	472	9,104	94.82	5.18	100
ASEAN6	42,337	1,685	44,022	96.17	3.83	100
Cambodia	238	2,877	3115	7.64	92.36	100
Lao PDR	1,297	801	2,098	61.82	38.18	100
Myanmar	2,848	732	3,580	79.55	20.45	100
Vietnam	3,566	1,939	5,505	64.78	35.22	100
ASEAN4	7,949	6,349	14,298	55.6	44.4	100
ASEAN10	50,286	8,034	58,360	86.17	13.83	100

Source: *ASEAN Secretariat* (2002).

2. Singapore Extra-ASEAN Free Trade Agreements and their implications for ASEAN

Singapore is an active member of the Association of Southeast Asian Nations (ASEAN) and a signatory of the ASEAN Free Trade Area (AFTA) whose ultimate objective is to create a regional market among the countries of Southeast Asia where goods and services can move freely across borders unhampered by any trade barriers. This vision will be realized in stages, and the year 2002 was the target year for the reduction of tariffs across the economies of the six older members (i.e. Indonesia, Malaysia, the Philippines, Singapore, Thailand and Brunei) to between 0 and 5 percent with the complete elimination of all trade barriers by 2015.

As a small open economy with high dependence on foreign trade, Singapore has been an active proponent for this regional economic initiative and considered it as one of the pillars of its foreign trade policy. However, right after the recent Asian economic crisis there has been a concerted effort by Singapore to establish free trade agreements (FTAs) with other countries - a deviation from its previous behaviour. After the formation of New Zealand-Singapore FTA, it has recently signed a free trade agreement with Japan and made substantial progress in its negotiations with the United States and Australia.

This section will attempt to provide an overview of the reasons behind Singapore's recent enthusiasm to forge FTAs with other countries outside the region and evaluate their economic implications for ASEAN and the validity of the concerns raised by other

ASEAN countries over Singapore's FTA initiatives. The economic evaluation will be based on a case study of the recently signed Japan-Singapore FTA.³

2.1. Why bilateral free trade agreements for Singapore?

Singapore's high dependence on trade has been widely documented. In fact, the country has one of the highest trade-to-GDP ratios in the world. Therefore, it is in the nation's interests to ensure that trade flows around the world will be as uninterrupted as possible. Hence, Singapore, described as 'a vocal champion of global free trade', has been one of the avid supporters of the multilateral trade negotiations under the auspices of the World Trade Organization (WTO). However, Singapore is also an active member of regional groupings such as the ASEAN Free Trade Area (AFTA) and the Asia Pacific Economic Cooperation (APEC). The recent initiatives at forging free trade agreements with countries outside the region could be interpreted as part of the overall trend towards regionalism.

One factor behind this trend relates to the growing doubt about the ability of the WTO to advance trade liberalisation under the multilateral system particularly after the failure of the WTO meeting in Seattle. Apart from the difficulty of reconciling the diverse and often conflicting interests of its 139 members, trade negotiations have also been complicated by the emergence of controversial issues like human rights, and environmental degradation. Moreover, there appears to be a lack of leadership in multilateral trade negotiations. With the U.S. becoming no longer a hegemonic power in international trade and given the absence of a dominant force directing negotiations, reaching a consensus in the organisation seems to be an insurmountable task. Singapore, like other proponents of FTAs, believes that reducing the number of negotiators can lead to a corresponding decrease in the number and complexity of issues involved, giving free trade negotiations a better chance of success. Building on this likely liberalisation of trade within FTAs, multilateral free trade can then be subsequently achieved. This is so, as domestic confidence regarding market liberalisation will be built up through FTAs, therefore preparing them for the multilateral stage (Ministry of Trade & Industry (MTI), Singapore). FTAs are, therefore, deemed to be building blocks to eventual global free trade. This positive view of FTAs have been endorsed by the WTO, which stated in its Singapore Ministerial Conference, that such agreements are complementary to the multilateral trading system.

Second, given the trend towards regionalism among developed countries, the formation of FTAs is considered as a way to maintain her bargaining position vis-à-vis other regional groupings and not to be left out of the major export markets. Indeed, Singapore's Trade and Industry Minister George Yeo had expressed concerns that these FTAs could deal Singapore out of the table. It is in these circumstances that Singapore decided to 'play the system' (Low, 2000), and thus embarked on a quest for FTAs with its 'strategic trading partners'. In doing so, Singapore will be able to maintain a foothold in the major regional groupings that have been formed and hence remain engaged in the global trading scene.

Apart from this trend towards regionalism, there could be other specific factors that have prompted Singapore's move to expedite the negotiations for bilateral free trade agreements with non-ASEAN countries:

³ The choice of Japan-Singapore FTA rather than the one-year old New Zealand-Singapore FTA is because Japan is ASEAN's major trading partner and source of foreign investment.

First, Singapore might have observed that AFTA has not been progressing as fast as she had expected. The growing emphasis on inward-looking policies after the 1997/98 Asian economic crisis in some ASEAN countries and Malaysia's deferment of its commitment to fully liberalize its automotive industry were seen as signs of backsliding on AFTA commitments. The anticipated slow progress in economic integration and the need for Singapore to position itself in the changing global trading environment have caused Singapore to form free trade agreements with other countries outside the region. As the Prime Minister Goh Chok Tong put it, "Those who can run faster should run faster. They shouldn't be restrained by those who don't want to run at all." (Reyes, *Asiaweek*, 2000).

Second, Singapore could be planning to reduce her dependence on the regional economies after the bitter experience with the recent regional economic crisis by forging closer economic integration with her major trading partners outside the region and thus ensuring economic resilience and security. Seen in this context, Singapore's bilateral pact with Japan would provide a launching pad for her to penetrate the wider East Asian economies, considering that Japan is also planning to form bilateral trading arrangements with Korea and China. Similarly, her approach to EFTA countries is done with the prospect of the larger but highly protective European market, while the Chilean and US initiatives are to link Singapore with the wider Latin and North American markets.⁴

2.2 Implications for ASEAN

Singapore's pursuit of extra-ASEAN FTAs has been criticized by some fellow ASEAN members. Apart from the criticism that other ASEAN countries were not adequately consulted by Singapore as to the objectives and modalities of the proposed pacts and how they would fit in within the AFTA process, these arrangements are seen by some as undermining ASEAN as a preferential trading arrangement. Specifically, it is claimed that these free trade arrangements could be providing Singapore's FTA partners with a backdoor entry into the ASEAN Free Trade Area. Are there any grounds for these criticisms?

2.2.1 Benefits for ASEAN?

Before addressing the major concerns raised by other ASEAN countries, there is a need to explore whether there are direct and indirect benefits that can be derived by other ASEAN countries from these extra-ASEAN FTAs. To be more explicit, the following analysis will focus on the new Japan-Singapore Free Trade Agreement (JSFTA), which is probably the most promising and important agreement for Singapore.⁵ Although the proposed US-Singapore agreement is also important, it has not yet been concluded as the one with Japan.

⁴ For more detailed discussions of Singapore's motivations to forge free trade agreements beyond the region, see Rajan *et al.* (2001).

⁵ On 12 October 2001 Japanese and Singaporean officials have finally agreed on the provisions for the proposed free trade agreement between their two countries after a series of negotiations. Formally known as the Japan-Singapore Economic Agreement for a New Age Partnership, this FTA was officially signed by their respective governments by early 2002 with an expected date of operation in the middle of 2002. This is Singapore's second FTA outside the region while first for Japan. The free trade agreement will also cover non-trade sectors including investments, services and customs procedures with cooperation in tourism and other fields (*The Straits Times*, 13 October 2001:4).

The Joint Study Group has explicitly laid down various measures for Singapore and Japan to cooperate that could have a direct impact on other ASEAN countries. For instance, if the proposal to build the Japan Business Centre in Singapore is realised, ASEAN countries will benefit from the joint ventures that Japanese and Singapore SMEs form. This is so, as one of the stated aims of this centre is to enable these joint ventures to collaborate in exploring business opportunities in ASEAN countries.

It was also suggested that the regulatory and policy framework that Singapore and Japan will cooperate in setting up to bring together their infocommunications and e-commerce industries could be extended to include the e-ASEAN⁶ initiative. The realisation of such a plan will see the entire ASEAN region market linked to Japan on the electronic realm. Such a situation is likely to boost the attractiveness of ASEAN countries as an investment location, since firms based in the relatively low-cost ASEAN countries will have electronic access to the vast Japanese market. However, doubts have been raised about the possibility of transforming the e-ASEAN plan into reality. This is mainly due to the diverse stages of development that the various ASEAN countries are in. Will there be political will to see through this long-drawn project, which entails the harmonising of the more sophisticated Singapore One and Multimedia Super Corridor (Malaysia) projects, with the barely-existent telecommunications network in Myanmar and Cambodia? Until such a project is completed, the proposed electronic link-up to Japan under the JSFTA is likely to remain a pipedream without concrete benefits for ASEAN.

Other specific measures include the provision of assistance for ASEAN members to develop their human resources. However, there have already been initiatives to do so even before the JSFTA was mooted. In 1997, an agreement was already sealed by the two countries to combine their resources to help developing countries through the "Japan-Singapore Partnership Programme for the 21st Century" (Deutsche Presse-Agentur, 7th May 1997). As such, any further attempts to assist the ASEAN countries in the area of human resource development could be provided under the auspices of this programme, thus rendering the efforts under the JSFTA to be largely duplicative and providing little additional benefits to the ASEAN countries.

Another recommendation by the Joint Study Group is that the Japan National Tourist Organisation (JNTO) and Singapore Tourism Board (STB) will cooperate in developing tourism in the region. Such an initiative can be beneficial for many of the ASEAN members, who count tourism as one of their important sources of revenue. However, there are also existing efforts to do so through the ASEAN Promotion Centre on Trade, Investment and Tourism.

By now, we should recognise the fact that Japan has maintained a strong relationship with ASEAN since the formalisation of the relationship in 1977. Despite fears that Japan may be losing interest in ASEAN as it turns its attention to its Northeast Asian neighbours, we see that Japan still maintains a variety of economic, social and political links to the ASEAN countries through platforms like the ASEAN Regional Forum (ARF), Japan-ASEAN Program for Comprehensive Human Resources Development, ASEAN-Japan Forum, Japan-ASEAN exchange project, etc. The ASEAN Promotion Centre on Trade, Investment and Tourism, which was established by Japan in 1981, also continues to realize its main aims of promoting exports from ASEAN to Japan, accelerating the inflow of investment from Japan to ASEAN, and to encourage Japanese tourists to visit ASEAN countries.

⁶ The e-ASEAN initiative is a bold move by the regional grouping to link their markets electronically, hence creating a 'seamless' market of 500 million people.

In view of the above, we could argue that if Singapore was keen on cooperating with Japan to provide various forms of assistance to its ASEAN counterparts, it has numerous opportunities to do so under the existing schemes. Hence, it is unlikely that the JSFTA will have much to offer to ASEAN in terms of providing a new link through which Japan can explicitly channel various forms of assistance.

Perhaps in recognition of the fact that the JSFTA may offer little extra benefits in terms of providing ASEAN with new avenues for assistance from Japan, Singapore's leaders have preferred to emphasise the 'catalytic' role that the JSFTA can provide for ASEAN. Although the JSFTA may not offer well-defined marginal economic benefits for ASEAN countries, there can be some spillover effects from the trade pact between Singapore and Japan. As the WTO secretary-general, Supachai Panitchpakdi, noted, 'Whatever Singapore does, it can generate spinoffs for ASEAN' (*The Business Times*, 21 February 2001) Indeed, PM Goh had argued that Singapore's trade pacts with non-ASEAN countries could 'help investors outside the region to look at the potentials of ASEAN as a whole' (*Agence France Presse*, 26 January 2001). This is important, as foreign investors' confidence in this region have been badly shaken by the Asian financial crisis and the series of political unrest in several ASEAN countries after the crisis. Japan's decision to forge a comprehensive agreement with an ASEAN country can thus be viewed as an endorsement of the long run prospects of the region, and hence pave the way for the international community to regain confidence and interest in this region.

Next, we should recognise that Singapore does not have unlimited capacity to absorb all of the investment that can result from the JSFTA. It is likely that the efforts to attract Japanese investors to Singapore through the various investment missions, and business seminars, can result in significant 'spill-overs' to the ASEAN countries. As mentioned earlier, Japanese investors in Singapore have tended to engage in 'third country investment' projects, using Singapore as a springboard for further investment in neighbouring countries. Hence, successful attempts to attract Japanese investors to Singapore through the schemes mooted under the JSFTA, can provide a valuable stepping stone towards further Japanese investment in the region as a whole. It has to be qualified that the abovementioned 'spillover' effects can only be realised if conditions in ASEAN countries are conducive for the investors. Thus, the onus is still on the ASEAN member countries to prove their viability and reliability as an investment location.

There have also been suggestions that Singapore's moves to conclude free-trade agreements can set the pace for other ASEAN countries to do the same in future. At present, many ASEAN countries are still dogged by the domestic problems that stemmed largely from the financial crisis in 1997/98. The preoccupation to resolve these internal issues has caused them to devote too little attention and resources to react to the international trend of regionalization. Singapore is therefore positioning itself as a convenient example that these ASEAN countries can follow when they are ready to forge FTAs after overcoming their domestic problems.⁷ However, fundamental differences between Singapore and its neighbours suggest that its experience in the JSFTA may be of limited use to its neighbours.

First of all, as Schott (1991) points out, an essential ingredient of a successful FTA is that the members have similar laws and regulations governing trade flows. Indeed, the JSFTA negotiations have been largely smooth going so far, as both countries see eye to eye on many issues, like the liberalising of trade flows in many goods and services. On the

⁷ Quite recently it has been reported that the Philippines and Thailand respectively are also pursuing similar free trade initiatives with Japan.

contrary, many sectors in ASEAN countries, like the automotive and financial industries have yet to be fully liberalised. Hence, as long as such protectionist inclinations persist in the ASEAN countries, it would be difficult for them to accept Singapore's guidelines for use in any of their future FTAs with Japan.

Next, Singapore is unlikely to face much domestic opposition to the FTA since it is at a relatively similar stage of development as Japan. This is so, as whatever trade that is created between Singapore and Japan as a result of the JSFTA, is likely to be intra- rather than inter-industry. As such, the FTA will cause minimal adjustments in trade flows, and thus insignificant redistribution of income and employment (Schott, 1991). In contrast to this, an FTA between Japan and the other less developed ASEAN countries may cause more domestic disruptions as the domestic capital-intensive industries may find themselves edged out by the more efficient Japanese producers. Thus, it might be less useful for ASEAN countries to seek reference from Singapore's experience in dealing with such FTA-related issues.

2.2.2 Concerns of ASEAN members

Although these initiatives could bring some indirect benefits for ASEAN, these bilateral trade pacts have been riddled with criticisms coming primarily from the former President of Indonesia Abdurrahman Wahid and Prime Minister of Malaysia Mahathir Mohamad. Both have shown no hesitation in attacking the actions of Singapore. Former President Wahid was calling Singaporeans as looking only after themselves in search for more profits. Prime Minister Mahathir has expressed concern that these non-ASEAN bilateral trading arrangements could undermine ASEAN solidarity. Singapore's formation of bilateral free trade agreements with New Zealand and Japan, and the pending ones with the US and Australia has been perceived as forsaking ASEAN interest for national interest. But the key contention is that Singapore could be providing its potential FTA partners with a backdoor into the AFTA. Critics have alleged that these FTA partners will be able to gain tariff-free access into ASEAN markets through Singapore, without providing reciprocal access to the ASEAN countries (*Asiaweek*, 8th December 2000).

A closer analysis of the situation however, reveals that there is little truth in this argument. The fundamental reason that refutes the 'back door' claim lies in the rules of origin. As defined by the WTO, these are essentially rules that 'define where a product was made'. Since members of an FTA often maintain their own tariffs on non-members, there is a tendency for countries outside the area to circumvent the higher tariffs in a member country by exporting to the lowest-tariff member country, and then re-exporting to the higher tariff ones, at the preferential tariff rate established under the FTA. Rules of origin will rein in such behaviour since products must fulfill the specified criteria before being able to enjoy the preferential tariff treatment granted by the FTA.⁸ In the case of AFTA, member countries' exports to one another will only be eligible for the Common Effective Preferential Tariff Scheme (CEPT),⁹ if these goods have a local content of 40%, i.e. 40% of the value-added to the product must originate from one or more ASEAN countries. Such requirements can inflate the costs of any foreign producer who attempts to

⁸ In practice, however, there are problems of implementation of the rules of origin in many countries due to inadequate and poor quality of institutions including poor bureaucracy, lack of transparency and so on.

⁹ This is a scheme through which ASEAN members seek to progressively lower the effective tariff levels among themselves, with the aim of reducing or eliminating the tariffs on various categories of goods like, manufactured products, pharmaceuticals, vegetable oils, etc. (AFTA Reader)

seek any back door entry into AFTA. This is so, as they will need to relocate the entire manufacturing plant, or at least split up the production process between the home and low-tariff AFTA country, in order to fulfill the 40% local content requirements. The costs involved in doing so are likely to offset any savings in tariff payments that result from the use of the 'back door'.

Approximately 96% of exports to Singapore are already exempted from any tariffs. This implies that the tariff differential between these exports to Singapore and those to other ASEAN countries is already at a maximum (at a tariff rate of 0% there is no further room for tariff reductions in Singapore for these imports). In view of these tariff differentials, Singapore already presents the opportunity for firms to gain a back door into AFTA. Thus, even without a bilateral pact with Singapore, foreign exporters who are keen on seeking a back door to any other ASEAN country would have already based at least 40% of their production process in Singapore to take advantage of the tariff differentials. It is probably safe to assume that the foreign exporters who have not done so, have had found the opportunity cost to be too great compared to any tariff payments that can be saved as a result.

It is unlikely that a bilateral trade pact with Singapore will provide much cause for these foreign exporters to review their decisions. The reason is as follows: Under Singapore's current FTAs, the only preferential tariff treatment granted to its partners is the elimination of customs duty on the dutiable goods. This means that only goods in 4 product categories¹⁰ will enjoy tariff concessions. Thus, if Singapore maintains such a criterion for its future FTAs, there will hardly be any further increase in the tariff differentials between any exports from its FTA partners to Singapore and those to the other AFTA members, that will make it worthwhile for exporters from the partner countries to try to use Singapore as a "backdoor" into the AFTA economies.

The automotive industry – An Example

The automotive industry is a prominent example of a protected industry in ASEAN countries. Under the AFTA CEPT scheme, ASEAN countries have agreed to reduce the tariffs on automotive imports from AFTA members, to a 0 to 5% range by 2002. However, these countries still maintain high tariffs on identical imports from non-AFTA countries. Thus, there could be fears that Japanese automotive firms may make use of this scheme to penetrate the ASEAN markets through Singapore, after the JSFTA comes into effect. Specifically, in order to fulfill AFTA's rules of origin, Japan may export 60%-completed motor vehicles into Singapore for completion, or even start a complete manufacturing plant from scratch in Singapore. The final product will then be exported into ASEAN countries at the stipulated preferential rate. Several factors however, will ensure that such a scenario will probably never materialise.

Firstly, major Japanese automotive firms like Mitsubishi Motors, Nissan and Toyota have already established automotive manufacturing plants in ASEAN countries like Thailand and the Philippines. These were facilitated by the ASEAN Industrial Complementation (AIC) and Brand-to-Brand (BBC) schemes, which provided reduced tariffs on automotive parts traded within the region (Yoshino, 2000). These schemes have, therefore, provided non-AFTA members with a somewhat *de facto* backdoor into AFTA. . By basing their production operations in ASEAN countries, Japanese firms are able to offset part of the high tariff costs of exporting into these countries, by procuring for cheaper intermediate products and manufacturing their vehicles within the region. Given

¹⁰ These are stout and porter, beer and ale, and medicated and other forms of samsoo (alcohol).

that Japanese automotive firms view the North American and EU countries as their main target markets, it is questionable if they will find it worthwhile to build an additional manufacturing or assembly plant in Singapore with the express purpose of penetrating an ASEAN market whose demands for Japanese vehicles can be adequately provided for by their (the Japanese's firms) existing plants in ASEAN.

The extreme case that these Japanese automobile firms will decide to establish manufacturing or assembly plants in Singapore in order to take advantage of the JSFTA and AFTA is even more remote. This is so, as there are no motor vehicle manufacturing or assembly plants in Singapore, and given the government's push to develop high value-added light manufacturing industries like electronics, it is unlikely to encourage the development of a car assembly or manufacturing plant in Singapore. Moreover, the high labour costs and land prices in Singapore can inflate the costs of production to reduce or even eliminate whatever cost savings from lower tariff payments under the CEPT.

More importantly, the CEPT scheme is carried out on a *quid pro quo* basis, where a member can only enjoy the preferential tariff if it reciprocates such tariff reduction. Singapore has placed motor vehicles on its General Exceptions List in the AFTA¹¹. As such, it is allowed to maintain its existing tariffs on motor vehicles imports from ASEAN countries. Thus, any automotive exports from Singapore to the other AFTA economies will not benefit from the CEPT scheme at all. This effectively eliminates any backdoor to AFTA for Japanese firms, as they will face the same tariff rates whether they export from Japan or Singapore.

Given all the above factors, the JSFTA is unlikely to offer any profitable back door for Japanese automotive firms that wish to circumvent the high tariffs in the other ASEAN countries through Singapore.¹²

Is Singapore leaving its neighbours behind?

As we see from the preceding discussion, the major economic reason for ASEAN's lukewarm attitude to the JSFTA (and Singapore's other FTAs in general) is more likely to be unsubstantiated. The core of their displeasure may lie in a less tangible domain. This is described succinctly by an editorial in Malaysia's national newspaper, *Berita Harian*. It commented that "Singapore may not have done any wrong in legal terms but morally, the republic's action showed that it had undermined friendship in ASEAN" (*Agence France Presse*, 25 November 2000). In seeking to enhance the bilateral relationship with countries outside the region, Singapore's actions have been perceived as that of forsaking its less prosperous neighbours and, in the former Indonesian President's words, "just look[ing] after themselves" (*The Business Times*, 27th November 2000).

In a sense, as Prime Minister Goh acknowledged, such accusations are 'right up to a point'. Singapore has long expressed its worries of the Southeast Asian region being relegated to the position of an 'Asian backwater', since ASEAN countries have yet to recover its pre-financial crisis vibrancy, while Northeast Asia continues to enjoy brighter growth prospects. Coupled with the trend towards the creation of FTAs in the other parts of the world, the country's initiatives to establish stronger bilateral relations with extra-regional countries are borne of necessity than choice. Given that the stability of its

¹¹ High taxes on motor vehicles are a vital tool in Singapore's supply management policy of its vehicle population, and it is unlikely that the country will make any exceptions for it under any free trade agreement that it enters.

¹² However, this possibility of trade deflection cannot be fully ruled out for other goods and services since under AFTA the rest of the ASEAN members will have to lower their duties to exports from Singapore – these lower duties could be significant enough to more than offset the costs of trade deflection.

relations with its neighbours will have a significant impact on its future, it is imperative for Singapore to seek a balance between its attitude of hard-nosed pragmatism, and the sensitivities of its neighbours. It has attempted to do so, by highlighting the positive impacts that its FTAs can have on its neighbours. However, as mentioned above, the JSFTA will probably offer little marginal benefits to ASEAN countries, while the spill-over effects are neither guaranteed nor highly quantifiable. As such, Singapore may have to continue to raise the profile of the various strategies that demonstrate its commitments to the region. Such strategies include direct investments in these countries¹³, and the provision of soft-loans to the countries in need, through the Asian Development Bank's soft-loan window. Nonetheless, given Singapore's image as the 'brainy kid classmates love to hate, but who some secretly admire' (*Asiaweek*, 8 December 2000), such political rhetoric by the neighbours is probably unavoidable, and the country will just have to take it in its stride.

3. Conclusion

Based on the analysis of recent developments, it seems that the crisis has not on the whole undermined the ASEAN countries' resolve to realize their vision to establish a regional free trade area despite the short-term negative implications of trade liberalization. Already significant progress has been made in the implementation of their trade liberalization commitments under AFTA, despite the growing economic and political difficulties faced by some member countries engendered by the recent economic crisis and other inherent structural and institutional weaknesses. Unilateral liberalization process in ASEAN has also begun, particularly in previously high tariff economies of Indonesia, the Philippines and Thailand. This has resulted in the harmonization of tariff structures to a considerable degree. Deregulation and privatisation have also complemented this trend. However, the second phase of economic integration poses a more challenging and difficult task due mainly to the significant differences that exist within these countries in terms of economic development, national priorities and levels of efficiency.

On the other hand, Singapore's recent initiatives to forge extra-ASEAN free trade agreements would not in any way undermine ASEAN's economic integration and its future. The fear that Singapore could be used as a backdoor entry into the ASEAN market has not been substantiated based on available evidence. Nor should these extra-ASEAN free trade initiatives by Singapore be interpreted as deserting ASEAN. Regionalism is considered to present opportunities for enlarging existing markets and other economic spill-over effects of trade liberalization, but more importantly, is considered important in maintaining regional peace and security, which is essential for long-term economic progress and security. Regionalism is especially important for Singapore, which is highly reliant on the region for its water and food supply. It is, therefore, against her strategic interest to ignore the importance of regionalism in favour of forging economic alliances with other countries.

As for the specific impact of the JSFTA on ASEAN, it may also turn out that little significant marginal economic gains are directly in store for these countries. Nevertheless, there could be some spin-offs for the ASEAN countries if the cooperation efforts between Singapore and Japan under their trade pact are successful. While we cannot confirm if ASEAN countries can gain significantly from the JSFTA, it is fairly safe

¹³ According to the Ministry of Trade & Industry, Singapore has been among the top investors in Indonesia, Thailand, Myanmar and Vietnam.

to believe that the concerns of the resulting negative adverse effects are unlikely to occur, although we cannot entirely rule out its possibility.

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