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10 Regionalism and Subregionalism in ASEAN: The Free Trade Area and Growth Triangle Models

Chia Siow Yue

10.1 Introduction

The Association of Southeast Asian Nations (ASEAN) was established in 1967 by the noncommunist and market-oriented economies of Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Brunei became a member in 1984. A new milestone was reached in July 1995 when Vietnam, a communist country undergoing transformation from a command to a market economy and a former adversary, joined ASEAN. The new ASEAN-7 is expected to expand to ASEAN-10 when the remaining countries of Southeast Asia, Cambodia, Laos, and Myanmar (CLM), join the grouping over the next few years. While the membership extension is expected to strain ASEAN's consensus-building style in the short term, it will contribute to regional peace, stability, and economic dynamism in the longer term.

ASEAN-6 (excluding Vietnam) has been widely regarded as the most successful economic cooperation grouping among developing countries. It was also the world's most economically dynamic region during the past decade. The collapse of oil and commodities prices starting in the early 1980s led the ASEAN-4 economies (Indonesia, Malaysia, the Philippines, and Thailand) to embark on far-reaching economic reforms, with deregulation, liberalization, privatization, and promotion of export manufacturing and foreign direct investment. The economic successes of the ASEAN-6 countries are due to national efforts rather than directly attributable to regional economic cooperation. Regional trade liberalization efforts have had little effect on intraregional trade, and industrial cooperation schemes have had no noticeable impact on industrial development in the ASEAN countries. In fact, ASEAN has often been

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criticized as lacking meaningful economic integration. However, to judge ASEAN as a regional grouping only by the criterion of economic integration is to misunderstand the role of ASEAN as envisaged by its founding fathers. The initial objective in ASEAN's formation was not economic integration based on the EC model, but the promotion of political stability and security in the region so as to provide the underpinnings for each country's economic development efforts.

Rapidly changing external and domestic environments, however, have led ASEAN to accelerate the process of economic integration since 1992 through the ASEAN free trade area (AFTA) and ASEAN growth triangles. These are not GATT/WTO-inconsistent, as they seek to improve regional and national competitiveness rather than to protect the ASEAN economies against external competition. This paper first discusses the diversities among ASEAN economies, their external orientation, and the first 25 years of economic cooperation efforts, before proceeding to an analysis of AFTA and growth triangles as modalities of regional economic cooperation.

10.2 The ASEAN Economies

10.2.1 Regional Diversities

The ASEAN-6 countries show considerable diversities in historical experience, sociocultural background, size, level of economic development, industrial structure, and trade orientation. Historically, Brunei, Malaysia, and Singapore were under British colonial rule, Indonesia under the Dutch, and the Philippines under the Spanish and Americans, while Thailand was never formally colonized. The colonial economies have been oriented toward the colonizing countries rather than toward Southeast Asia or East Asia, and postcolonial efforts to strengthen regional trading ties have been inhibited by similarities in resource endowment and in level of industrial competence and by limited linking infrastructure.

Indonesia is the largest member of ASEAN in geographical area, population, and GNP (table 10.1). It has a population of 191 million, compared to Singapore's 2.9 million and Brunei's 300,000. However, it is the least economically advanced ASEAN economy, with a 1994 per capita income of U.S.$880, as against U.S.$23,360 for Singapore. Per capita income differences in ASEAN are larger than found in other developing country groupings. In ASEAN, the largest country is also the least developed so that differences in economic size are not as stark. Indonesia's GNP in 1993, unadjusted for purchasing power parity (PPP), was only 2.5 times larger than Singapore's; adjusted for PPP, however, Indonesia's GNP was almost 11 times Singapore's. Indonesia's low profile as a regional hegemon has contributed to ASEAN harmony.

The ASEAN economies, excepting Singapore, are rich in natural resources,

Table 10.1 Basic Indicators of ASEAN Economies

Indicator	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-6
Land area (thousand sq. km)	5.8	1,919.4	329.8	300.0	0.6	513.1	3,062.9
Population, 1994 (million)	0.3	190.7	19.5	68.6	2.9	59.4	341.4
Total GNP, 1993 (million U.S. $)	n.a.	136,990	60,060	54,610	55,370	120,240	427,270.0[a]
Per capita GNP, 1994 (U.S. $)	n.a.	880	3,520	960	23,360	2,210	1,468[a]
PPP adjusted, 1993	n.a.	3,150	8,400	2,670	19,510	6,260	n.a.
GDP real growth rate (%)							
1971–80	n.a.	7.7	7.8	6.0	7.9	7.9	n.a.
1981–90	n.a.	5.5	5.2	1.0	6.3	7.9	n.a.
1991	n.a.	6.9	8.7	−0.5	6.7	8.1	n.a.
1992	n.a.	6.4	7.8	0.1	5.8	7.6	n.a.
1993	n.a.	6.5	8.3	2.1	10.1	8.2	n.a.
1994	n.a.	7.5	9.2	4.4	10.1	8.7	n.a.
1995	n.a.	7.6	9.3	4.8	8.9	8.6	n.a.
Agriculture/GDP share (%)							
1975	n.a.	31.7	27.7	30.3	1.9	26.9	n.a.
1994	n.a.	17.4	14.5	22.0	0.2	11.1	n.a.
Manufacturing/GDP share (%)							
1975	n.a.	8.9	16.4	25.7	23.9	18.7	n.a.
1994	n.a.	23.9	30.1	23.3	27.0	27.0	n.a.
Total trade/GNP (%)							
1975	n.a.	40.8	82.2	40.9	236.1	36.9	n.a.
1994	n.a.	49.4	179.3	54.5	289.6	67.8	n.a.
Direct investment inflow/GNP (%)							
1980	n.a.	0.3	3.8	0.0	9.7	0.6	n.a.
1992	n.a.	1.4	8.6	0.5	9.7	1.9	n.a.

Sources: Asian Development Bank (1995, 1996) and World Bank (1995).

[a]Excludes Brunei.

and their economic development until the 1970s was largely resource based. Since then, the ASEAN-4 countries have been rapidly industrializing and reducing their dependence on primary products. As is common among developing countries, industrialization started with import substitution. The switch to export manufacturing was half-hearted in the 1970s, but the collapse of oil and commodity prices in the early 1980s led to a stronger export orientation. The import liberalization ratio (unrestricted imports to total imports) reached more than 95 percent in Malaysia and Thailand by 1985, 83 percent in the Philippines by 1986, and 84 percent in Indonesia by 1987 (World Bank 1987). The rapid growth of manufactured exports has been facilitated by massive inflows of foreign direct investment. The share of manufactures in total exports rose dramatically from 2 percent in 1970 to 53 percent in 1993 for Indonesia, from 7 percent to 65 percent for Malaysia, from 7 percent to 77 percent for the Philippines, and from 8 percent to 73 percent for Thailand (World Bank 1995). Brunei remains an oil-dependent economy, with industrialization prospects severely constrained by its small population base. Singapore with its strategic location and free trade policy has served as the regional entrepôt for centuries. It is the manufacturing base of multinational corporations (MNCs) and a regional commercial, transportation, and financial hub.

10.2.2 Intra- and Extraregional Trade and Investment Linkages

The ASEAN-6 countries have highly open economies, as measured by trade-GNP ratios (table 10.1) and the extent of foreign investment penetration, with the smaller economies more open than the larger ones. However, extraregional trade and investment linkages are quantitatively more important than intraregional linkages. The main trading partners of the ASEAN-6 are the OECD countries, both for import sourcing and for export markets. For imports, the ASEAN-6 is most dependent on Japan, followed by the United States and the European Union (table 10.2). For exports, the ASEAN-6 is most dependent on the United States, followed by Japan and the European Union. The grouping is thus seriously concerned with rising regionalism in North America and Europe and possibilities of reduced market access. The asymmetrical and triangular relationship is most evident in the trade in manufactures; the ASEAN-6 is heavily dependent on Japan as a source of capital goods and on the United States as a market for manufactures. In 1992, Japan accounted for 26 and 10 percent of imports and exports, respectively, of manufactures of the ASEAN-6, while the United States accounted for less than 15 percent of imports and over 20 percent of exports of manufactures.

Although ASEAN has existed since 1967 and has implemented preferential trading arrangements since 1977, intra-ASEAN trade has neither become more important nor grown faster than extra-ASEAN trade, so that trade diversion has not been dominant. In 1993, intra-ASEAN trade accounted for 19.3 percent of the total trade of the ASEAN-6, with a share of 18.1 percent for imports and 20.7 percent for exports (table 10.2). While the intra-ASEAN share of ASEAN

Table 10.2 **Trade Matrix of ASEAN Economies, 1993**

Country	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-6	Vietnam	East Asia[a]	Japan	EU	U.S.	World	World (million U.S. $)
						Exports (percentage distribution)								
Brunei		0.0	0.1	2.3	8.3	8.6	19.3	0.0	76.1	54.2	17.9	1.2	100.0	2,373
Indonesia	0.1		1.6	0.8	9.2	1.3	12.9	0.5	55.7	30.3	14.4	14.2	100.0	36,843
Malaysia	0.4	1.2		1.0	21.7	3.6	27.9	0.3	54.5	13.0	14.5	20.3	100.0	47,080
Philippines	0.0	0.4	1.4		3.4	1.5	6.7	0.4	34.9	16.3	16.9	38.3	100.0	11,279
Singapore	0.8	2.4	13.8	1.8		5.6	24.4	1.3	51.0	7.3	13.7	19.9	100.0	75,864
Thailand	0.1	0.5	2.8	0.5	12.0		16.0	0.3	26.9	17.0	17.0	21.6	100.0	37,111
ASEAN-6	0.4	1.2	5.8	1.1	8.9	3.2	20.7	0.7	47.8	15.3	14.8	20.1	100.0	210,550
Vietnam	0.0	1.2	2.8	0.4	10.6	2.6	17.6		65.1	32.3	19.6	0.0	100.0	3,018
						Imports (percentage distribution)								
Brunei		1.8	8.0	0.1	26.8	1.5	38.3	0.0	45.7	5.4	27.1	20.2	100.0	2,601
Indonesia	0.0		1.8	0.2	6.3	0.8	9.2	0.1	46.7	22.1	19.9	11.5	100.0	28,333
Malaysia	0.0	1.6		0.5	15.3	2.5	19.8	0.2	60.4	27.5	11.6	17.0	100.0	45,552
Philippines	0.3	0.6	2.0		5.7	1.0	9.6	0.1	49.4	22.8	10.3	19.8	100.0	17,965
Singapore	0.2	3.8	15.8	0.6		4.0	24.4	0.4	58.5	21.0	11.0	15.7	100.0	88,765
Thailand	0.4	1.1	3.6	0.4	6.4		12.0	0.2	55.2	30.3	14.9	11.7	100.0	46,065
ASEAN-6	0.2	2.1	7.3	0.4	5.9	2.2	18.1	0.3	55.9	24.3	13.2	15.0	100.0	229,281
Vietnam	0.0	3.5	2.8	0.8	20.0	2.4	29.5		83.7	13.1	11.2	0.1	100.0	5,394
						Exports + Imports (percentage distribution)								
Brunei	0.0	1.0	4.2	1.1	18.0	4.9	29.3	0.0	60.2	28.7	22.7	11.2	100.0	4,974
Indonesia	0.1	0.0	1.7	0.5	7.9	1.1	11.3	0.3	51.8	26.7	16.8	13.0	100.0	65,176
Malaysia	0.2	1.4	0.0	0.8	18.5	3.1	23.9	0.2	57.4	20.1	13.1	18.7	100.0	92.632
Philippines	0.2	0.5	1.8	0.0	4.8	1.2	8.5	0.2	43.8	20.3	12.8	26.9	100.0	29,244
Singapore	0.5	3.1	14.9	1.1	0.0	4.7	24.4	0.8	55.0	14.7	12.3	17.6	100.0	164,629
Thailand	0.3	0.9	3.3	0.5	8.9	0.0	13.8	0.2	42.6	24.4	15.9	16.1	100.0	83,176
ASEAN-6	0.3	1.7	6.6	0.8	7.3	2.7	19.3	0.5	52.0	20.0	13.9	17.4	100.0	439,831
Vietnam	0.0	2.7	2.8	0.7	16.6	2.4	25.2	0.0	77.0	20.0	14.2	0.1	100.0	8,412

Source: International Monetary Fund (1994).

[a]East Asia = Japan, China, Hong Kong, South Korea, Taiwan, ASEAN-6, Vietnam, Laos, and Cambodia.

Table 10.3 **Intra-ASEAN Trade Matrix, 1980 and 1993**

Country	Year	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-6	ASEAN-6 (million U.S. $)
				Exports (percentage distribution)					
Brunei	1980		0.0	7.6	8.8	51.4	32.3	100.0	585
	1993		0.2	0.4	11.8	42.8	44.8	100.0	458
Indonesia	1980	0.0		2.2	6.6	90.0	1.3	100.0	2,760
	1993	0.9		12.3	6.0	70.9	9.8	100.0	4,754
Malaysia	1980	0.8	1.2		6.8	84.8	6.4	100.0	2,923
	1993	1.4	4.1		3.7	77.9	12.9	100.0	13,134
Philippines	1980	0.8	28.2	24.8		29.6	16.6	100.0	381
	1993	0.3	5.8	21.2		50.9	21.8	100.0	760
Singapore	1980	5.3	17.9	55.5	5.2		16.1	100.0	5,238
	1993	3.4	9.7	56.7	7.4		22.8	100.0	18,511
Thailand	1980	0.9	22.2	27.5	2.2	47.2		100.0	1,065
	1993	0.6	3.4	17.5	3.3	75.1		100.0	5,936
ASEAN-6	1980	2.4	10.1	26.2	5.6	45.4	10.2	100.0	12,952
	1993	2.1	5.9	28.2	5.5	42.8	15.5	100.0	43,553
				Imports (percentage distribution)					
Brunei	1980		0.3	15.6	1.9	72.6	9.5	100.0	150
	1993		4.8	20.9	0.3	70.0	4.0	100.0	997
Indonesia	1980	0.0		2.7	6.7	69.3	21.3	100.0	1,350
	1993	0.0		19.9	2.2	68.9	9.0	100.0	2,603
Malaysia	1980	0.1	4.6		6.0	71.3	18.0	100.0	1,774
	1993	0.0	8.0		2.4	77.0	12.6	100.0	9,029

Philippines	1980	9.9	33.4	29.0		23.7	3.9	100.0	559
	1993	3.5	6.1	21.1		59.2	10.1	100.0	1,729
Singapore	1980	3.0	37.9	50.7	1.1		7.2	100.0	6,556
	1993	1.0	15.6	64.9	2.3		16.2	100.0	21,652
Thailand	1980	20.1	4.1	27.1	2.2	46.5		100.0	1,105
	1993	3.2	9.3	30.3	3.3	53.8		100.0	5,516
ASEAN-6	1980	4.1	24.4	33.5	2.6	25.7	9.8	100.0	11,494
	1993	1.1	11.5	40.5	2.3	32.4	12.3	100.0	41,526
				Exports + Imports (percentage distribution)					
Brunei	1980		0.1	9.2	7.4	55.7	27.6	100.0	735
	1993		3.4	14.4	3.9	61.4	16.8	100.0	1,455
Indonesia	1980	0.0		2.3	6.6	83.2	7.9	100.0	4,110
	1993	0.9		15.0	4.6	70.2	9.6	100.0	7,357
Malaysia	1980	0.5	2.4		6.5	79.7	10.8	100.0	4,697
	1993	0.9	5.7		3.2	77.5	12.8	100.0	22,163
Philippines	1980	6.2	31.3	27.3		26.1	9.0	100.0	940
	1993	2.5	6.0	21.1		56.6	13.7	100.0	2,489
Singapore	1980	4.0	29.0	52.8	3.0		11.2	100.0	11,794
	1993	2.1	12.9	61.1	4.7		19.2	100.0	130,479
Thailand	1980	10.6	13.1	27.3	2.2	46.9		100.0	2,170
	1993	1.9	6.2	23.7	3.3	64.9		100.0	11,452
ASEAN-6	1980	3.2	16.8	29.6	4.2	36.1	10.0	100.0	24,446
	1993	1.6	8.6	34.2	3.9	37.7	13.9	100.0	85,079

Source: International Monetary Fund, *Direction of Trade Statistics Yearbook* (Washington, D.C., various issues).

imports has grown significantly since 1970, the share for exports has not shown an upward trend. Singapore, the most trade-oriented ASEAN country and the region's entrepôt, accounted for the largest share of intra-ASEAN trade (table 10.3), followed by Malaysia, while Brunei and the Philippines combined accounted for less than 6 percent. Excluding Singapore, intra-ASEAN trade falls to less than 5 percent of ASEAN's total trade. The bulk of intra-ASEAN trade is accounted for by bilateral trade between Singapore and Malaysia. Low trade linkages among the ASEAN countries (excluding Singapore) reflect low economic complementarity and similar levels of industrial competence. The countries produce largely similar processed resources and labor-intensive manufactures. They cannot absorb each other's primary products and cannot supply each other's needs for technology and capital goods. They compete with each other for markets in North America, Europe, and Japan. However, in recent years, trade linkages have expanded with the growth of FDI-related intraindustry trade.

The ASEAN region has strong locational advantages and is a major recipient of FDI (table 10.4). Indonesia accounted for the largest share of the inward FDI stock, followed by Singapore, Malaysia, Thailand, and the Philippines. FDI inflows accelerated in the 1980s, particularly in the post-1987 period. The traditional sources of FDI were the United States and Western Europe. Japan became a major source in the 1970s and particularly after the sharp yen appreciation in the mid-1980s (Chia 1993). While Singapore has remained dependent on FDI from the Triad (United States, European Community, and Japan), the ASEAN-4 countries have experienced a surge in FDI from the Asian NIEs in recent years. Vietnam has also become a strong contender for FDI, both from the Asian NIEs and ASEAN and, more recently, from Japan.

Intra-ASEAN investment (excluding Vietnam) remained small relative to inflows from outside the group, although it is suspected that a sizable amount of intraregional investment is not captured by official statistics. As shown in table 10.4, intra-ASEAN investment accounted for only 9.2 percent of ASEAN's total FDI stock in 1992, with a 6.3 percent share of the inward investment stock and 33.3 percent share of the outward investment stock. The low level of intraregional industrial investment reflects the facts that the ASEAN economies depend on extraregional sources for capital and technology and ASEAN investors possess limited ownership advantages over local firms. As show in table 10.5, Singapore is the main regional investor, while Malaysia is the main recipient. Over 75 percent of the intraregional investment stock in 1992 is between Singapore and Malaysia. This strong bilateral investment link mirrors the strong bilateral trade link. The strong Singapore-Malaysia trade and investment linkages reflect common historical ties under British colonial rule, close geographical proximity (a common border), and strong economic complementarity.

Table 10.4 **Foreign Direct Investment Matrix of ASEAN Economies, 1992**

Country	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-5	East Asia	NIEs-3	Japan	EU	U.S.	World	World (million U.S.$)
					Inward FDI Stock (percentage distribution)								
Indonesia		0.2	0.0	3.3	0.2	3.7	43.7	19.3	20.7	10.7	4.3	100.0	63,016
Malaysia	3.6		0.2	10.4	0.3	14.5	60.3	23.7	21.6	17.9	9.0	100.0	22,584
Philippines	n.a.	0.3		1.0	n.a.	1.2	31.4	9.1	21.0	10.5	47.4	100.0	4,011
Singapore	0.1	3.9	0.3		0.9	5.2	35.2	6.5	23.3	23.1	17.0	100.0	34,446
Thailand	0.1	0.4	0.1	8.5		9.1	66.0	22.7	34.0	10.2	17.3	100.0	12,435
ASEAN-5	0.6	1.1	0.1	4.0	0.3	6.3	45.9	16.8	22.7	15.0	10.8	100.0	136,492
					Outward FDI Stock (percentage distribution)								
Indonesia		34.5	0.0	1.6	0.7	36.8	40.8	2.6	0.4	49.2	4.2	100.0	2,383
Malaysia	6.2		0.6	64.2	2.2	73.1	81.9	7.3	n.a.	0.3	3.5	100.0	2,104
Philippines	1.7	5.1		10.5	0.8	18.0	89.6	66.6	n.a.	2.5	7.8	100.0	874
Singapore	1.9	22.1	0.6		2.6	27.1	48.7	19.5	0.4	7.2	9.0	100.0	10,786
Thailand	3.0	1.1	0.0	12.8		17.0	50.2	29.7	0.6	5.4	35.3	100.0	705
ASEAN-5	2.2	19.3	0.5	9.3	2.1	33.3	53.9	18.5	0.4	12.0	8.6	100.0	16,852
					Inward + Outward FDI Stock (percentage distribution)								
Indonesia		1.5	0.0	3.2	0.2	4.9	43.6	18.7	20.0	12.1	4.3	100.0	65,399
Malaysia	3.9		0.2	15.0	0.5	19.5	62.1	22.3	19.7	16.4	8.6	100.0	24,688
Philippines	0.3	1.2		2.7	0.1	4.3	41.8	19.4	17.3	9.1	40.3	100.0	4,885
Singapore	0.5	8.3	0.3		1.3	10.4	38.4	9.6	17.6	19.3	15.1	100.0	45,232
Thailand	0.3	0.4	0.1	8.7		9.5	65.1	23.1	32.2	10.0	18.3	100.0	13,140
ASEAN-5	0.8	3.1	0.2	4.6	0.5	9.2	46.8	17.0	20.2	14.6	10.5	100.0	153,345

Source: APEC Secretariat 1995.

Table 10.5 Intra-ASEAN Direct Investment Matrix, 1980 and 1992

Country	Year	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-5	ASEAN-5 (million U.S.$)
				Inward FDI Stock (percentage distribution)				
Indonesia	1980		12.3	19.5	65.1	3.0	100.0	207
	1992		5.7	0.6	89.5	4.2	100.0	2,304
Malaysia	1980	0.1		0.0	99.0	0.8	100.0	1,699
	1992	25.1		1.4	71.6	2.0	100.0	3,280
Philippines	1980	0.0	7.1		92.9	0.0	100.0	6
	1992	0.0	23.6		76.4	0.0	100.0	50
Singapore	1980	9.0	86.3	1.4		3.4	100.0	379
	1992	2.1	75.3	5.1		17.5	100.0	1,793
Thailand	1980	0.7	17.3	4.4	77.6		100.0	74
	1992	1.5	4.1	0.6	93.8		100.0	1,127
ASEAN-5	1980	1.6	15.5	2.1	79.5	1.4	100.0	2,365
	1992	10.2	18.0	1.8	64.4	5.6	100.0	8,554
				Outward FDI Stock (percentage distribution)				
Indonesia	1980		6.0	0.0	92.6	1.4	100.0	37
	1992		93.8	0.0	4.3	1.9	100.0	877
Malaysia	1980	7.0		0.1	89.4	3.5	100.0	366
	1992	8.5		0.8	87.7	3.0	100.0	1,539
Philippines	1980	81.5	1.0		10.9	6.7	100.0	50
	1992	9.4	28.1		58.0	4.4	100.0	158
Singapore	1980	3.6	93.6	1.8		1.0	100.0	503
	1992	6.8	81.5	2.2		9.5	100.0	2,923
Thailand	1980	0.0	0.0	0.0	100.0		100.0	1
	1992	17.8	6.5	0.1	75.6		100.0	120
ASEAN-5	1980	8.8	49.6	1.0	38.4	2.3	100.0	956
	1992	6.5	58.0	1.4	27.9	6.2	100.0	5,616
				Inward + Outward FDI Stock (percentage distribution)				
Indonesia	1980		11.4	16.6	69.3	2.8	100.0	243
	1992		30.0	0.5	66.0	3.6	100.0	3,181
Malaysia	1980	1.3		0.0	97.3	1.3	100.0	2,065
	1992	19.8		1.2	76.7	2.3	100.0	4,819
Philippines	1980	73.2	1.6		19.2	6.0	100.0	55
	1992	7.1	27.0		62.5	3.4	100.0	208
Singapore	1980	5.9	90.5	1.6		2.0	100.0	882
	1992	5.0	79.1	3.3		12.6	100.0	4,716
Thailand	1980	0.7	17.2	4.4	77.8		100.0	75
	1992	3.1	4.3	0.6	92.0		100.0	1,246
ASEAN-5	1980	3.6	25.3	1.8	67.7	1.6	100.0	3,320
	1992	8.8	33.8	1.7	49.9	5.8	100.0	14,170

Source: APEC Secretariat 1995.

10.3 Economic Cooperation Rationale and Modalities

10.3.1 Rationale for Cooperation

ASEAN's formation was motivated more by political and strategic than by economic considerations (Khoman 1992; Rajaratnam 1992). The Cold War, the Indochina conflicts, domestic communist insurgency activities, and fear of falling dominoes propelled the noncommunist countries of Southeast Asia to put aside territorial disputes and form a club to promote regional stability and security, with economic development providing the underpinnings. ASEAN, therefore, has both a political security dimension and an economic dimension.

ASEAN is generally perceived to have been successful in achieving its political security goals. First, the grouping has made remarkable strides in promoting political cohesion and reducing territorial conflicts.[1] Regional stability has provided the environment in which individual ASEAN countries can pursue their economic development goals. Second, ASEAN solidarity has enabled the grouping to play an increasingly influential role in the political and strategic affairs of the Asia Pacific. ASEAN has established regular formal dialogues with global and regional powers. ASEAN has also become a focal point for dialogues and arrangements on regional security with the establishment of the ASEAN Regional Forum in 1994. Third, ASEAN's political influence has extended into wider regional and global economic forums, giving it influence out of proportion to its economic strength. This is particularly evident in the Asia Pacific Economic Cooperation (APEC) forum, where ASEAN positions carry considerable weight and ASEAN members alternate with other APEC members in assuming the annual leadership role.[2]

Perhaps ASEAN's sustainability as a regional economic grouping lay in rejecting the EC economic integration model in its formative years, and in practicing the principles of accommodation and of consensus in decision making. For the first 25 years of ASEAN's existence, official documents avoided the term "integration" and emphasized only "cooperation," as ASEAN policymakers were not prepared to consider either a free trade area or a customs union as they pursued national import substitution strategies. Further, the agenda for economic cooperation, as laid out in the 1976 ASEAN Concord, was reached only nine years after ASEAN's establishment. The Concord provided, inter alia, for economic cooperation in trade and industrial development, banking and finance, food and energy, tourism and transport, and joint approaches to international economic issues. ASEAN has been fairly successful in various

1. During 1963–65 Indonesia launched a confrontation against the newly formed Federation of Malaysia (which then included Singapore) in protest against the inclusion of the Borneo states of Sabah and Sarawak in the new federation. There are overlapping territorial claims among all the ASEAN nations.

2. The United States hosted the first APEC summit and headed the APEC Secretariat in 1993, followed by Indonesia in 1994, Japan in 1995, and the Philippines in 1996.

areas of functional cooperation and in maintaining a joint approach toward extra-ASEAN economic relations (Chia 1994). ASEAN economic ministers and officials meet regularly to exchange information and views, develop common positions, and initiate and review action programs.

Aspects of economic cooperation other than trade and industrial cooperation will not be discussed in this paper.[3] The principles of accommodation and consensus in decision making have meant that those that wished to move at a faster pace had to accommodate the more cautious and smaller members need not fear the dominance of larger members. However, the resulting convoy effect has slowed the pace of economic cooperation. The less developed ASEAN member countries were reluctant to open their markets to competition from the more advanced members, and the more advanced countries were reluctant to enter into exclusive industrial cooperation arrangements with the inefficient industries of the less advanced members, which would adversely affect their overall competitiveness.

In 1992, the ASEAN-6 reached a milestone agreement to form a free trade area and pushed for further subregional economic integration via formation of growth triangles. The changed mindset and more serious attempts at economic integration reflected the interplay of both external and domestic political and economic forces. The end of the Cold War and the Indochina conflict have weakened ASEAN's political and strategic underpinnings; previously, ASEAN was of strategic interest to the global superpowers, and geopolitical interests also kept ASEAN members united and purposeful. At the same time, developments in the economic arena increased the acceptability of economic integration and a free trade area. First, the ASEAN-4 economies had been undergoing unilateral liberalization since the mid-1980s, resulting in outward-looking trade and investment strategies, converging tariff levels, and increased FDI inflows directed at export manufacturing. The less developed ASEAN economies gained industrial competence, lessening the fear of competition from the more advanced ASEAN economies. With the growth of intraindustry trade, ASEAN economies became more complementary and integrated. Second, Fortress Europe, the emergence of NAFTA, and the slow progress of the Uruguay Round gave rise to concerns over market access for ASEAN's rapidly growing export-oriented industries. A regional market provides a strategic fallback position and improves ASEAN's bargaining leverage vis-à-vis trading blocs and protectionist trading partners.

Third, ASEAN-6 faces growing competition from the transitional economies of Eastern Europe, China, and Indochina, as well as from the liberalizing economies in Latin America and South Asia. Trade liberalization removes price distortions, and an integrated regional market will enable ASEAN industries

3. For discussions of ASEAN cooperation in food and energy, banking and finance, and transport and tourism, see the articles by Cabanilla, Sharma, Schulze, Wong, and Naidu in Sandhu et al. (1992).

to benefit from internal competition, economies of scale, and regional specialization according to comparative advantage. Intra-ASEAN trade liberalization could be a useful stepping stone toward multilateral liberalization and international competitiveness. Fourth, as the global competition for FDI intensified in the 1980s there was concern over possible investment diversion to China, Indochina, India, Eastern Europe, and Mexico, as many of these countries have either huge domestic markets or lower cost structures or both. An ASEAN free trade area will increase the attraction of ASEAN as a production base and as a market for MNCs. Intra-ASEAN trade liberalization could also exploit the trend of MNCs toward globalization of production, encouraging them to establish and expand production bases in ASEAN and develop intraregional production networks.

10.3.2 Trade and Industrial Cooperation during 1976–92

From the perspective of economic integration, the most important programs are those aimed at intraregional trade liberalization and industrial cooperation. However, perceptions of zero-sum competition and politically unacceptable distribution of benefits and costs have resulted in slow progress. The ASEAN Preferential Trading Arrangement (PTA) was introduced in 1977 as the main instrument to promote intraregional trade, but there was lack of serious intent as member countries continued to pursue national import substitution. The initial product-by-product approach and the requirement to periodically exchange a prescribed number of tariff preferences led to bizarre results that reduced the credibility of ASEAN economic cooperation. The tariff classification was disaggregated, and the number of tariff items subject to preferences ballooned without much growth in trade values. Further, negotiated items included products insignificant in intra-ASEAN trade or not even produced or consumed in ASEAN countries, such as nuclear reactors and snowplows. Subsequent attempts at limited across-the-board tariff reductions were largely nullified by exclusion lists that included many products with significant intra-ASEAN trade potential. Nontariff barriers further eroded the effectiveness of tariff preferences. As a result, the PTA scheme had only a marginal impact on intra-ASEAN trade, as reflected in the low PTA utilization rate. Out of a total of 12,783 items on the PTA list in 1986, only 337, or 2.6 percent, of the items were granted tariff preferences, and only 19 percent of the total value of these items satisfied the eligibility criteria and actually enjoyed tariff preferences (Pangestu, Soesastro, and Ahmad 1992).

ASEAN also implemented three industrial cooperation schemes with limited success, namely, the ASEAN Industrial Projects (AIP), the ASEAN Industrial Complementation (AIC) scheme, and the ASEAN Industrial Joint Ventures (AIJV). The AIP was initiated in 1976 and was meant to be a showpiece of regional economic cooperation. However, the scheme led to contentious disputes between government officials over choice and location of regional projects. In the end only two projects were implemented. The AIC scheme was

introduced in 1981 and modified into the Brand-to-Brand (BBC) scheme in 1988 to encourage regional production and exchange of automotive parts and components for specified automotive brand models. Some 70 BBC projects have been approved, involving more than 10 automotive manufacturers. The AIJV scheme was introduced in 1983 to encourage industrial investment through resource pooling and market-sharing activities. A total of 23 AIJV projects have been approved. Although the AIC, BBC, and AIJV schemes emphasized private sector participation, continuing government efforts to influence industrial location, the cumbersome and slow bureaucratic approval process, and nonparticipation by some countries reduced the attraction and viability of the schemes.

The limited progress with the ASEAN trade liberalization and industrial cooperation schemes noted above reflects lack of economic complementarity, different levels of industrial competence, pursuit of national import substitution strategies, and perceptions of zero-sum competition. First, the structures of the ASEAN-4 economies were more competitive than complementary. Being at similar initial stages of industrialization, each ASEAN country wanted to protect its industries from foreign (including ASEAN) competition. Second, where economic complementarity did exist, as between Singapore and the ASEAN-4, there was fear of an unacceptable regional division of labor and distribution of benefits and costs if investment decisions were left to market forces. The perception was that Singapore, with the most advanced and competitive economy, would benefit most from regional free trade. Solution of the distributive issue in ASEAN was hampered by the fact that the largest economy, Indonesia, was also the least developed, while the richer economies of Brunei and Singapore were small and had limited capacity to fund regional structural adjustment and development cooperation programs. To resolve the deadlocks that resulted from applying the principle of consensus, ASEAN adopted the "6 minus x" principle, which allowed individual countries to opt out of participation in specific cooperation schemes.

10.3.3 ASEAN Free Trade Area (AFTA)

The fourth ASEAN summit of January 1992 agreed to the establishment of a free trade area. AFTA is intended to help ASEAN economies achieve greater trade and investment competitiveness in the global economy. AFTA (including Vietnam) will have an integrated regional market of over 400 million people with a combined purchasing power of over U.S.$400 billion growing at 6–8 percent a year and embraces countries with a wide range of resource endowment and skills. The pooling of resources and markets would increase the attraction of the ASEAN region to regional and foreign investors. MNCs locating in ASEAN will be able to exploit scale economies and rationalize production, allocating different segments of the value chain, production processes, and products among the ASEAN countries according to their respective competitive advantages.

AFTA focuses on the liberalization of trade in goods within the ASEAN region through implementation of the Common Effective Preferential Tariff (CEPT). However, the CEPT scheme as first agreed upon in January 1992 had several limitations. First, unlike NAFTA, which contained over 2,000 pages of technical details, the AFTA and CEPT agreements were brief documents of intent, lacking details regarding rules and procedures for tariff and nontariff reductions, harmonization of tariff codes, determination of local content, and mechanism for dispute settlement. The CEPT agreement was largely hammered out by government officials, without prior studies on feasibilities and impacts and little public debate on the issues. Second, the CEPT agreement had a time frame of 15 years (up to 2008) to bring tariffs down to 0–5 percent, covering manufactures (including processed agricultural products), but excluding unprocessed agricultural products. The time frame was too long and would render AFTA irrelevant in view of the agreements reached in the Uruguay Round, the proposals for APEC trade and investment liberalization, and the competitive challenges ASEAN countries face for export markets and foreign investments. As it was, the fall in investment commitments in 1992–93 in Indonesia and Malaysia was attributed in part to investment diversion to China and, to a lesser extent, to Vietnam. In recognition of these factors, in September 1994 the ASEAN governments agreed to shorten the time frame to 10 years (2003) and to extend the sectoral coverage to all goods, including unprocessed agricultural products.

Third, the flexibility allowed in setting start-up dates and frequency and depth of tariff cuts to the 20 percent level in the first eight years provided the opportunity for individual countries to procrastinate. There were strong pressures in some countries to delay implementation, as industry groups fearful of regional competition lobbied for more time for adjustment. Press reports of such delays undermined the credibility of AFTA, and the flexible time schedule created uncertainty for business planning. This led to the subsequent decision that all countries would have to implement the CEPT by January 1994, with a six-month delay for Brunei.

Fourth, in view of the reciprocity condition, very few CEPT items will reach commonality of preferences until the end of the implementation time frame; tariff preferences will be largely bilateral (Wisarn 1994). Likewise, the temporary exclusion list includes a large number of items in electrical machinery, automobiles, and parts and accessories, that is, tariff items that are of interest to the globalization strategy of MNCs. ASEAN countries urgently need to harmonize their tariff regimes to facilitate common preference accession and utilization, and the temporary lists should be reduced through more frequent reviews.

Fifth, administering the 40 percent rule of origin (national and cumulative) and keeping some tariffs at the 5 percent level raise the transaction costs of intraregional trade. The 40 percent rule represented a compromise; too high a requirement would disqualify many products from the CEPT concessions, but

too low a requirement would increase the probability of trade deflection, as extraregional imports would enter the ASEAN market via low-tariff countries and free trade zones. However, to the extent that the objective of the CEPT is to improve the competitiveness of ASEAN industries rather than to protect ASEAN markets, trade deflection should not be a contentious issue; ASEAN should not discriminate against lower-cost non-ASEAN sourcing of capital goods, intermediate inputs, and raw materials as these would help improve ASEAN competitiveness.

For a product to enjoy CEPT concessions it must satisfy the following—be on the CEPT inclusion lists of both exporting and importing countries, have an approved tariff reduction schedule, and have at least 40 percent ASEAN content either on a single-country or cumulative-ASEAN basis; products that have tariff rates of 20 percent and below in the exporting country are eligible for concessions on these products in the importing country, while products that have tariff rates of over 20 percent in the exporting country can enjoy the concessions on these products in the importing country only if the tariffs on these products are also over 20 percent. Quantitative restrictions would be removed upon enjoyment of CEPT concessions, but other nontariff barriers would be eliminated only within five years from enjoyment of concessions.

As is evident from table 10.6, there is a wide dispersion of tariff rates among ASEAN countries and among sectors. By 1995 Singapore had dismantled all CEPTs. Thailand has the highest average tariff level (16.9 percent), followed by the Philippines (13.8 percent), Indonesia (12.6 percent), Malaysia (7.3 percent), and Brunei (2.6 percent). There are no tariffs above 20 percent average at the sectoral level in Malaysia and Brunei. In Thailand, they are found on food products, plastics, wood and wood products, footwear, arms and ammunition, and miscellaneous manufactured articles; in Indonesia, they are found on foodstuffs, plastics, footwear, miscellaneous manufactured articles, and works of art and antiques; and in the Philippines, they are confined to arms and ammunition, miscellaneous manufactured articles, and works of art and antiques.

The CEPT reductions follow a dual track schedule. Under the fast track schedule covering over 15 product groups, tariffs of 20 percent and below will be reduced to 0–5 percent by 1998, while those above 20 percent will be reduced to the same level by 2000.[4] Under the normal track schedule covering all other CEPT product groups, tariffs of 20 percent and below will be reduced to 0–5 percent by 2000, while tariffs above 20 percent will be reduced in two stages, to 20 percent by 1998 and to 0–5 percent by 2003. For the first stage, there is no preagreed schedule of tariff reduction to the 20 percent level; indi-

4. Initially, 15 product groups were identified for the fast track, namely, vegetable oils, chemicals, fertilizers, rubber products, pulp and paper, wooden and rattan furniture, gems and jewelery products, cement, pharmaceuticals, plastics, leather products, textiles, ceramics and glass products, copper cathodes, and electronics. These have since been extended to include machinery and mineral products.

Table 10.6 CEPT Rates by Country and Sector, 1995

HS	Sector	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand
Total		2.60	12.64	7.28	13.82	0.00	16.90
01-05	Live animal, animal products	0.00	20.60	12.05	19.00	0.00	27.06
06-14	Vegetable products	0.00	13.24	2.58	13.36	0.00	26.60
15	Fats and oils	0.00	7.44	1.60	18.10	0.00	20.09
16-24	Prepared foodstuffs, beverages	0.04	24.62	6.08	17.39	0.00	25.70
25-27	Mineral products	0.00	3.74	1.61	6.56	0.00	9.68
38	Chemicals	0.70	7.86	1.31	8.53	0.00	12.20
39-40	Plastics	0.25	21.76	10.88	16.85	0.00	22.24
41-43	Hides and leather	0.73	14.13	4.96	15.60	0.00	14.70
44-46	Wood and wood products	7.89	16.70	14.18	11.94	0.00	21.63
47-49	Pulp and paper	0.00	14.07	8.34	10.56	0.00	19.88
50-63	Textiles, apparel	3.85	13.74	10.19	18.22	0.00	19.50
64-67	Footwear, umbrellas	3.40	32.82	11.24	16.83	0.00	24.61
68-70	Stone, ceramics, cement, glass	0.57	17.97	7.61	17.01	0.00	19.98
71	Gems	2.55	13.25	3.64	5.77	0.00	15.07
72-83	Base metals, metal products	0.09	12.18	5.52	14.77	0.00	13.08
84-85	Machinery, electrical products	7.97	10.59	5.15	11.08	0.00	11.84
86-89	Vehicles	0.00	6.97	10.35	6.08	0.00	16.72
90-92	Optical, precision instruments	1.50	11.35	2.90	11.45	0.00	13.59
93	Arms and ammunition	0.00	0.00	8.46	22.50	0.00	28.06
94-96	Miscellaneous manufactured articles	0.00	28.70	8.56	26.10	0.00	24.58
97-98	Works of art, antiques	0.00	24.69	7.50	21.64	0.00	15.83

Source: ASEAN Secretariat, unpublished data.

vidual countries were given the freedom to decide on starting dates and frequency and depth of tariff cuts, which meant that cuts could effectively be postponed to as close to the deadline as possible. For the second stage, tariff reduction follows a preagreed schedule. The CEPT provides for two categories of exclusions. The general exclusion list includes products exempted on public policy grounds, such as national security, public morals, and protection of goods of artistic, historic, or archaeological value; most exempted products are armaments, animals and plants, and alcoholic beverages. A temporary exclusion list exempts certain sensitive items; however, these products will be transferred into the inclusion list in five equal installments starting in January 1996.

The tariff items covered by the CEPT are shown in table 10.7. Of a total of 44,095 tariff items, 58.8 percent are in the normal track, 33.7 percent in the

Table 10.7 **Tariff Lines in the CEPT by Country and Sector**

HS	Sector	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-6
				Normal Track				
Total		3,618	4,539	5,710	3,432	3,473	5,146	25,918
01-24	Live animals, food	826	838	564	294	776	490	3,788
25-27	Mineral products	169	192	163	117	149	204	994
38-40	Chemicals, plastics	369	347	460	347	295	696	2,513
41-49	Leather, wood, paper	255	284	1,754	232	249	350	3,124
50-63	Textiles, apparel	5	0	0	400	0	0	405
54-67	Footwear	59	110	91	35	59	112	466
68-71	Stone, ceramics, cement	55	100	68	62	53	85	423
72-83	Base metals, metal products	586	999	1,150	675	623	1,217	5,250
84-85	Machinery, electrical products	723	1,032	704	784	750	1,143	5,136
86-89	Vehicles	185	121	237	96	124	264	1,027
90-92	Optical, precision instruments	215	298	270	243	227	387	1,640
93-98	Miscellaneous	171	218	228	145	151	166	1,079
				Fast Track				
Total		2,377	2,819	2,985	960	2,183	3,531	14,855
01-24	Live animals, food	53	60	157	8	40	74	392
25-27	Mineral products	5	10	4	7	5	5	38
38-40	Chemicals, plastics	858	464	1,228	607	751	1,201	5,109
41-49	Leather, wood, paper	80	51	108	35	82	146	502

50-63	Textiles, apparel	1,009	1,803	990	91	975	1,758	6,626
64-67	Footwear	0	0	0	0	0	0	0
68-71	Stone, ceramics, cement	144	248	132	107	142	201	974
72-83	Base metals, metal products	8	0	1	1	1	2	13
84-85	Machinery, electrical products	220	156	345	94	165	144	1,124
86-89	Vehicles	0	0	0	0	0	0	0
90-92	Optical, precision instruments	0	0	0	0	0	0	0
93-98	Miscellaneous	0	27	20	10	22	0	79
				Temporary Exclusion List				
Total		236	1,648	621	694	1	122	3,322
01-24	Live animals, food	0	193	18	104	0	28	343
25-27	Mineral products	9	6	43	43	0	0	103
38-40	Chemicals, plastics	95	850	123	41	0	0	1,109
41-49	Leather, wood, paper	0	310	108	104	0	0	522
50-63	Textiles, apparel	0	27	4	268	0	0	299
64-67	Footwear	0	1	0	23	0	0	24
68-71	Stone, ceramics, cement	0	12	27	39	0	0	78
72-83	Base metals, metal products	0	57	112	0	0	3	172
84-85	Machinery, electrical products	72	48	43	17	0	34	214
86-89	Vehicles	0	129	143	54	0	57	383
90-92	Optical, precision instruments	60	8	0	0	1	0	59
93-98	Miscellaneous	0	5	0	1	0	0	6

Source: ASEAN Secretariat (1995a).

Table 10.8 **Average CEPT Rates by Country, 1996–2003**

Country	1996	1997	1998	1999	2000	2001	2002	2003
Brunei	2.46	2.29	1.91	1.74	1.39	1.39	1.39	1.39
Indonesia	11.63	10.61	8.84	7.91	5.81	5.70	5.00	4.25
Malaysia	5.93	5.14	4.42	3.67	2.90	2.83	2.83	2.83
Philippines	9.17	8.33	7.16	6.53	5.42	4.90	4.89	3.73
Singapore	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	14.10	12.69	10.15	9.28	7.00	6.99	5.78	4.63
ASEAN-6	7.76	7.00	5.79	5.19	3.97	3.88	3.47	2.95

Source: ASEAN Secretariat (1995b).

fast track, and 7.5 percent in the temporary exclusion list.[5] The largest numbers of normal track tariff items are in base metals and metal products and machinery and electrical appliances. Almost half the fast track items are textiles and garments. The temporary exclusion lists represent sectors and products which the ASEAN countries are not yet ready to liberalize. They are concentrated in chemicals and plastics and motor vehicles. Among countries, machinery and electrical appliances ranked first in the exclusion list of Brunei, chemicals in Indonesia, textiles in the Philippines, and vehicles in Malaysia and Thailand. The simple average of the CEPT rates was 12.8 percent in 1993, ranging from a high of 22.6 percent for Thailand to a low of 0.4 percent for Singapore. The average CEPT rate for the ASEAN-6 will fall to 2.3 percent by 2003, ranging from 4.6 percent for Thailand to zero tariffs for Singapore (table 10.8).

Intraregional trade in CEPT products grew rapidly in 1993–94. Intraregional exports of CEPT products reached U.S.$32.8 billion in 1993 and rose to U.S.$49.8 billion in 1994 (excluding Singaporean exports to Indonesia for which data are not available), recording 51.7 percent growth (table 10.9). Singapore accounted for 54.2 percent of the CEPT exports in 1994, followed by Malaysia (25.9 percent), Indonesia (10.1 percent), Thailand (6.6 percent), the Philippines (2.3 percent), and Brunei (0.9 percent). Singapore is the leading export destination for all the ASEAN countries, except for Brunei. Singapore and the Philippines experienced the fastest growth in CEPT exports of over 90 percent. For intraregional imports of CEPT products in 1994 (excluding Singaporean imports from Indonesia for which data are not available), Singapore accounted for 60.5 percent, followed by Malaysia (20.8 percent), Thailand (7.7 percent), Indonesia (5.6 percent), the Philippines (3.3 percent), and Brunei (2.1 percent). Singapore is the leading import source for all ASEAN countries except Thailand.

The fifth ASEAN summit in December 1995 endorsed an accelerated tariff

5. The tariff lines are not strictly comparable across countries and sectors due to differences between levels of disaggregation. While Brunei, Indonesia, Malaysia, and Singapore have tariff codes disaggregated at the nine-digit level, those of the Philippines are disaggregated at the eight-digit level, and those of Thailand are a mixture of six-digit and nine-digit codes.

Table 10.9 Intra-ASEAN Trade of CEPT Products, 1993–94 (million U.S. dollars)

Country	Year	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-6
				Exports				
Brunei	1993		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	1994		0	37	28	198	201	464
	% Growth		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Indonesia	1993	22		496	260	3,046	430	4,255
	1994	39		600	319	3,722	333	5,013
	% Growth	75.6		20.9	22.8	22.2	−22.7	17.8
Malaysia	1993	143	479		429	8,448	1,632	11,131
	1994	186	605		536	9,582	2,015	12,922
	% Growth	30	26		25	13	23	16
Philippines	1993	1	29	125		302	129	586
	1994	2	44	166		619	296	1,127
	% Growth	83.3	52.2	33.5		104.7	129.4	92.4
Singapore	1993	585	n.a.	9,187	1,121		3,169	14,062
	1994	843	n.a.	19,484	1,425		5,249	27,001
	% Growth	44.1	n.a.	112.1	27.1		65.7	92.0
Thailand	1993	15	84	278	63	2,359		2,799
	1994	18	136	316	75	2,741		3,285
	% Growth	18.4	61.4	13.7	19.7	16.2		17.4
ASEAN-6	1993	766	591	10,085	1,873	14,156	5,361	32,833
	1994	1,088	785	20,603	2,383	16,861	8,094	49,813
	% Growth	42.0	32.7	104.3	27.2	19.1	51.0	51.7
				Imports				
Brunei	1993		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	1994		54	225	2	575	60	916
	% Growth		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Indonesia	1993	1		411	42	1,543	149	2,146
	1994	0		489	55	1,631	231	2,406
	% Growth	−67.1		18.9	30.9	5.7	55.6	12.1
Malaysia	1993	2	441		200	5,469	789	6,902
	1994	28	627		303	6,799	1,131	8,889
	% Growth	1,559.3	42.2		51.5	24.3	43.4	28.8
Philippines	1993	0	212	167		635	87	1,101
	1994	0	246	238		795	130	1,408
	% Growth	352.5	15.9	42.3		25.2	49.2	27.9
Singapore	1993	216	n.a.	13,629	493		3,448	17,786
	1994	250	n.a.	19,106	883		5,629	25,869
	% Growth	16.1	n.a.	40.2	79.1		63.3	45.4
Thailand	1993	217	269	891	95	936		2,408
	1994	150	232	1,500	186	1,213		3,280
	% Growth	−30.9	−13.9	68.3	96.0	29.6		36.2
ASEAN-6	1993	435	922	15,099	830	8,583	4,473	30,342
	1994	429	1,158	21,557	1,429	11,013	7,182	42,769
	% Growth	−1.3	25.6	42.8	72.2	28.3	60.6	41.0

Source: ASEAN Secretariat (1995b).

reduction schedule for 1996 that included the first installment of products previously in the temporary exclusion list, the bulk of unprocessed agricultural products, and the first package by Vietnam (which joined AFTA in January 1996). This package comprised 94 percent of the total number of tariff lines in ASEAN.

AFTA cannot be inward looking. The ASEAN regional market is too small for inward-looking regionalism, so that the promotion of intra-ASEAN trade should not be at the expense of extra-ASEAN trade. Further, to the extent that ASEAN production is heavily dependent on extraregional sourcing of capital and intermediate inputs, focusing on intra-ASEAN trade liberalization alone would not significantly reduce production costs. ASEAN countries need to simultaneously reduce barriers on imports of production inputs from non-ASEAN sources. Intraregional trade liberalization should be seen as the first step toward global liberalization. In fact, when Singapore implemented its AFTA obligations by removing almost all tariffs in 1993, it also decided to multilateralize its tariff concessions. More recently, Indonesia has announced a program of tariff reductions, lowering both CEPTs and most-favored-nation tariffs, though the latter were kept higher than the former.

10.3.4 Extending beyond the CEPT

The 1992 AFTA agreement has the CEPT as its cornerstone, with general provisions for the exploration of nonborder areas of cooperation, such as the harmonization of standards, reciprocal recognition of tests and certification of products, removal of barriers to foreign investment, macroeconomic consultations, fair competition rules, and promotion of venture capital.[6] The AFTA agreement is much less comprehensive and specific than NAFTA, which has extensive and specific provisions on liberalization of nontariff barriers, trade in services, and investment flows and on protection of intellectual property. Since 1992, however, ASEAN has not only accelerated its tariff reductions but also progressively extended its liberalization and cooperation schemes to include these areas.

The CEPT focuses on tariff reductions and intra-ASEAN trade liberalization in goods. Yet tariffs may not represent the most serious obstacle to intra-ASEAN trade, and tariff reductions may have no substantive impact on trade growth.[7] Quantitative restrictions and other nontariff barriers are often more

6. The ASEAN Secretariat was asked to look into nonborder areas of cooperation. Products at the HS seven- and nine-digit levels are being reviewed to ensure comparability of product nomenclature. The ASEAN Consultative Committee on Standards and Quality was established to work on harmonization of standards, testing of accreditation of laboratories, conformity assessment, and technical information. The Consultative Forum on Foreign Direct Investment was convened in February 1993 and meets on a regular basis to exchange views as to how to improve the investment climate in ASEAN.

7. One study by Imada, Montes, and Naya (1991) based on a partial equilibrium approach has shown that an assumed 50 percent tariff cut would increase intra-ASEAN trade as a percentage of

serious deterrents to intra-ASEAN trade than tariffs.[8] Traders are discouraged by border barriers such as tedious import documentation and procedures and disputes over arbitrary customs valuation and rules of origin, as well as by nonborder obstacles such as lack of harmonized standards, sanitary regulations, and labeling and packaging requirements. Further, liberalizing intra-ASEAN trade alone may not be the best approach to fostering ASEAN export and investment competitiveness. Additionally, the focus on merchandise trade neglects the growing importance of trade in services and investment flows.

In September 1994 ASEAN officials agreed on the harmonization of tariff nomenclature in ASEAN beyond the HS six-digit international uniform definition, that is at the HS eight- to nine-digit level. On nontariff barriers, officials are cooperating on customs valuation systems and procedures, including common customs declaration forms and import and export procedures; elimination of nontariff barriers relating to technical standards; and harmonization and mutual recognition of sanitary and phytosanitary measures for agriculture products. In April 1995 ASEAN officials agreed to work toward a Framework Agreement on Cooperation in Services, to include liberalization as well as cooperation in trade in services, the idea being to go beyond the Uruguay Round General Agreement on Trade in Services (GATS); to implement a Framework Agreement on Intellectual Property Cooperation and set up an ASEAN patent system and an ASEAN trademark system; and to explore cooperation in transport and communication as a trade facilitation measure.

In December 1995, the ASEAN summit adopted the ASEAN Industrial Cooperation (AICO) scheme to replace the BBC and AIJV schemes. The approval process is simpler and speedier, with applications processed within two months. AICO products will enjoy immediate free market access rather than the scheduled tariff reductions under AFTA. To be eligible, a project has to involve at least two ASEAN countries and companies must have at least 30 percent national equity. In response to the growing concern regarding ASEAN's competitiveness as an investment location, the ASEAN summit also agreed to establish an ASEAN Investment Area (AIA) to complement AFTA, to promote foreign and intraregional direct investments. A working group has been established to explore specific measures.

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total trade by 2.3 percent for imports and 3.4 percent for exports. The biggest gainer on the import side would be Malaysia (4.4 percent) and on the export side Singapore (4.2 percent). To the extent that dynamic effects are not considered, the gains have been underestimated. The same study, using a general equilibrium trade-linked model, has shown the gains to be larger. Malaysia would have the largest share of intra-ASEAN exports (35.6 percent), while Singapore would have the largest share of intra-ASEAN imports (33.0 percent).

8. Kumar (1992) highlighted some of the nontariff barriers in intra-ASEAN trade, including standards testing procedures, customs classifications and valuation procedures, subsidy schemes for domestic producers and purchasers, local content rules, and health and safety standards.

10.3.5 ASEAN Growth Triangles

The Growth of Subregionalism

Subregionalism is a growing phenomenon in East Asia, as manifested in the rapid emergence of subregional economic zones (SREZs), variously called growth triangles, transnational economic zones, and natural economic territories. These are transnational investment zones that encompass geographically contiguous countries and subnational areas. The integration process has cut across not only political boundaries but also political and economic systems. The driving force is the private sector. Governments act as facilitators, removing the political and policy barriers to economic exchange, providing and promoting the development of physical infrastructure, and offering investment incentives to the private sector.

SREZs exploit the advantages of geographical proximity and economic complementarity (Chia and Lee 1993). Geographical proximity is often linked with cultural and linguistic affinities, and together they reduce economic distance and transaction costs, but the removal of policies restricting border flows and the availability of facilitating transportation and telecommunications must still be addressed. Border restrictions have been tumbling in East Asia with the end of the Cold War and with political and economic reforms in socialist countries and trade and investment liberalization among market economies. For trade in goods, proximity reduces transport costs as well as delivery time, an important consideration with time-sensitive products, rapid changes in consumer tastes and shortened product cycles. For trade in services, direct contacts between producers and suppliers and between buyers and clients are often necessary for transactions to take place. For investment decisions, proximity reduces information costs, of particular importance for small and medium-sized enterprises without ready access to investment and market information, and for investors who have to operate in unfamiliar political, bureaucratic, and legal environments with complex and nontransparent rules and regulations, and deal with local business partners with different business and accounting practices. Transportation and telecommunications infrastructures are needed to enable cross-border movements of goods and people and flows of information. Supporting infrastructure is also needed to promote development of natural resources, tourism, and industries.

Economic complementarity arises from differences in factor endowments and in stages of economic development and is reflected by differential factor prices and cost structures. As land and natural resources are immobile and governments continue to restrict cross-border labor flows, capital becomes the mobile factor and investments flow from the more developed core of the SREZ to the less developed periphery. The core also performs an intermediation role, channeling investments from other countries to the periphery, helping to import machinery and intermediate inputs needed by the periphery and exporting its products to the rest of the world.

The most developed SREZ is the Greater South China zone encompassing Hong Kong, Taiwan, and China's south coastal provinces of Fujian and Guangdong, where geographical proximity has been facilitated by ethnic, cultural, and linguistic affinities.[9] In the ASEAN region, three growth triangles among member states have emerged, and national and subnational governments act as the major facilitators.

IMS, IMT, and BIMP Growth Triangles

The IMS (Indonesia-Malaysia-Singapore) Growth Triangle (GT), more commonly known as the SIJORI (Singapore-Johor-Riau) Growth Triangle, was proposed in the late 1980s as an alternative mode of ASEAN economic cooperation to the more contentious FTA. It does not require the participation of all ASEAN countries (the "6 minus x" principle) and emphasizes resource pooling and investment cooperation rather than market integration. The IMS-GT comprises the three contiguous areas of Indonesia's Riau islands, Malaysia's southern state of Johor, and the city-state of Singapore. The growth triangle enhances the investment competitiveness of the subregion by combining the resources and advantages of economically advanced and less advanced areas, integrating the availability of capital, technology, and human resources with the availability of land, natural resources, and labor. Such a combination of productive resources is generally not simultaneously available within a national contiguous area at a given time. For this reason, a transnational growth triangle is a much more attractive investment location than a national economic zone. At the subregional level, there are economies of scale and clustering and specialization according to comparative advantage. At the enterprise level, geographical proximity facilitates the establishment of production and distribution networks.

Government support has been crucial in launching the IMS-GT. Indonesia proposed investment cooperation with Singapore to increase the attraction of Riau as an investment destination as its earlier effort to promote Batam island (part of Riau) as a logistics base and industrial export processing zone had met with limited success. The development of Riau also serves Indonesia's strategy of developing its regional peripheries. For Johor, further integration with Singapore will enable it to exploit the metropolitan spillover effect to accelerate its economic and industrial development. For the Singapore city-state, Riau and Johor provide much-needed economic space. Land and labor shortages and accompanying rising costs necessitate the relocation of land- and labor-intensive industries and processes. Relocation nearby will enable foreign MNCs in Singapore to retain their higher value-added functions in Singapore and thus consolidate Singapore's position as a manufacturing base and services hub. Relocation nearby by Singaporean enterprises will enable them to engage

9. For a comparison of ASEAN growth triangles and the Greater South China SREZ, see Chia and Lee (1993).

in outward investments in a less unfamiliar environment, which reduces risks and helps economize on managerial and technical resources. Singapore's cooperation is also strongly motivated by its heavy dependence on Johor for water supply and its search for new water resources in Riau.

The liberalization of foreign investment regulations in Batam (where regulations are more liberal than found in the rest of Indonesia), Singapore's participation in Batam's infrastructural development, and strong Singapore government endorsement of Batam as an industrial location led to a surge of investment in Batam by foreign MNCs based in Singapore and by Singaporean companies. The success of Batam led to investment cooperation's being extended to Bintan and other Riau islands. Singaporean investments include multibillion-dollar joint ventures with the Indonesian private sector to develop industrial and tourism facilities in Batam and Bintan.

Geographical proximity and economic complementarity are crucial factors in the development of IMS-GT. For businesses located in Batam-Bintan and Johor, doing business with and through Singapore is much more cost efficient and time saving as Singapore provides world class transportation, telecommunications, financial, and commercial infrastructures. Batam is only a 30–45-minute ferry ride from Singapore, and Johor is linked to Singapore by a causeway (with another under construction). Investors can commute daily or frequently from Singapore to supervise operations and attend to production and distribution problems. Singapore offers a more comfortable and convenient living environment for business executives and their families. There are also strong economic complementarities between Singapore and Johor and Riau. Singapore has abundant financial resources, managerial and professional expertise, and well-developed financial, transportation, and telecommunications infrastructure. Riau and Johor can offer land and labor at lower cost than in Singapore. Their unique proximity to Singapore increases their attraction for regional and foreign investors.

The success of the IMS-GT has prompted the implementation of two more growth triangles in ASEAN. The northern, or IMT (Indonesia-Malaysia-Thailand), Growth Triangle covers contiguous areas of west Indonesia, north Malaysia, and south Thailand, with a larger geographical area and population base than the IMS-GT. The eastern, or BIMP-EAGA (Brunei-Indonesia-Malaysia-Philippines East ASEAN) Growth Area encompasses four ASEAN countries: Brunei, west Indonesia, east Malaysia, and south Philippines. It is larger than the IMT-GT in area and is geographically more dispersed. In both cases, facilitating transportation infrastructure is crucial to the development of subnational linkages.

Issues and Challenges

The IMS-GT is a transnational phenomenon involving relations at many levels. The relocation of industries from the core to the periphery results in retrenchment of workers and possible industrial hollowing-out. However,

Singapore's outward investment in response to labor and land shortages and industrial upgrading will create domestic dislocations anyway, whether the growth triangle phenomenon exists or not. In a dynamic economy the retrenched workers can be readily redeployed, particularly if appropriate retraining programs are in place, and scarce domestic resources can be put to more productive use. In the peripheral areas of Johor and Batam, the influx of foreign investment and associated managerial and professional resources raises economic growth and employment and industrialization prospects. However, rapid foreign investment penetration has raised concerns about national sovereignty, the centrifugal forces that draw a country's periphery to a foreign core, dilution of central-provincial government relations, and inadequate economic linkages with the domestic economy. The presence of foreign investors, managerial and professional personnel, and visitors also puts pressure on housing and infrastructure, and a large influx of workers from rural areas, particularly young female workers, can create social problems.

The sustainability of the IMS-GT depends on the continuing investment attractions of Johor and Riau. For Johor an emerging problem is the worsening shortage of labor, and investors will have to move into non-labor-intensive industries. For Batam and Riau, the need to recruit labor from Java and the 30-year land-lease system add to production costs and investor uncertainty. And as Indonesia liberalizes its investment regime, the special investment incentives for Riau are lost; Java has the strong attraction of a large labor pool and a large domestic market. A recent Indonesian government decision has extended the land lease to 80 years, and developments on Bintan are focusing on tourism and natural resource development as well.

Geographical proximity and economic complementarity are less obvious in the IMT-GT and BIMP-EAGA than in the IMS-GT. A lack of transportation infrastructure linking the subnational areas, particularly in the BIMP-EAGA, has increased economic distance and transaction costs. The subnational areas in these two growth triangles are also more alike in terms of factor endowments and levels of economic and industrial development. Neither triangle has an equivalent to Singapore in the IMS-GT, a participant that provides metropolitan spillover and investment, financial, transportation, telecommunications, commercial, and managerial resources. In the IMT-GT, Penang acts as the metropolitan core, but Penang is much smaller than Singapore and its hinterland lies in Malaysia rather than across the border. In the BIMP-EAGA, Brunei is financially rich and Labuan (Malaysia) is an emerging offshore financial center, but the growth triangle lacks an industrial leader.

The IMT-GT and BIMP-EAGA will thus need a different focus from the IMS-GT. Subregional cooperation will need to emphasize the joint development of infrastructure, natural resources, and tourism. This will enable the two subregions to enjoy economies of scale and agglomeration and to improve their competitiveness in securing investment. For common resources straddling land and sea borders, joint development can minimize ownership disputes and im-

prove environmental management. However, the central challenge in the development of the IMT-GT and BIMP-EAGA is mobilizing the financial resources required for infrastructure-related development. Total infrastructure financing needs of developing East Asia over the next five to six years are estimated to be U.S.$1–2.5 trillion, and only a very small part of this is likely to be met from the resources of multilateral and regional development agencies and official development assistance programs. The bulk of financing required for investment in infrastructure development and in productive capacity in the IMT-GT and BIMP-EAGA will have to be mobilized from private sources. Both private loan financing and private investments have to meet stringent criteria regarding political and management risks and commercial viability. It remains to be seen how many of the ambitious schemes envisaged and proposed in the IMT-GT and BIMP-EAGA can meet such criteria.

10.3.6 Growth Triangle versus Free Trade Area

The growth triangle has several advantages over the free trade area (FTA) as a modality of ASEAN economic cooperation.

First, the growth triangle avoids some of the problems in regional economic integration faced by countries at different stages of economic development, and even different economic and political systems (as demonstrated by the Greater South China economic zone). The FTA is a formal institutionalized regional arrangement. Negotiations can be protracted, as they must cover a wide range of trade-related policies and regulations. Wide disparities in income levels, industrial competence, and trade policy create serious problems in reaching consensus on the pace and extent of trade liberalization and perception of distribution of benefits and costs. In contrast, the growth triangle exploits differences in factor endowments and levels of development to mutual advantage. Furthermore, the "6 minus x" principle is easier to implement in a growth triangle than in an FTA. Countries that see little benefit need not participate, but they do not spoil the chances for countries that wish to do so.

Second, a growth triangle is more limited in geographical scope and thus politically more manageable and functionally more flexible. Existing growth triangles cover only parts of sovereign states, except for the small city-state of Singapore and the small sultanate of Brunei. For countries unready to open up across the board and lacking financial resources for infrastructural development of peripheral areas, participation in a growth triangle limits political risks and financial commitments. If the experiment in economic cooperation fails, the political risks can be well contained; if it is successful, the experiment can be replicated in different parts of the country and with different partners. The scope for cooperation is more flexible. It need not include or end with intra-trade liberalization. In actual practice, cooperation has included joint investments in infrastructure, tourism, and industry and facilitation measures for investments and the flow of goods and people, and the integration process is

deeper than in an FTA. It takes less time to implement specific cooperation schemes in a growth triangle, and the benefits are more directly visible.

Third, for larger and geographically dispersed countries, a growth triangle helps promote balanced regional development, as peripheral areas of a country can be drawn into the mainstream of development by linking with more developed areas across the border. A country can participate in several growth triangles at the same time, with different modalities of cooperation and projects to meet specific local needs and conditions. Thus Indonesia is linking its northwestern, southern, and eastern peripheries to different growth triangles in ASEAN with different combinations of partners.

Fourth, a growth triangle focuses on economic complementarity to attract investments to produce for the subregional and international markets rather than on enlarging the regional market and protecting it against external competition. A growth triangle is less likely to be perceived as a zero-sum game. Domestic enterprises are less threatened by more competitive goods from partner countries. And since a growth triangle is obviously not a discriminatory trading bloc, it is also more acceptable to nonmembers. In fact, nonmembers are actively encouraged to participate in the benefits of the triangle through the investment process. A growth triangle is thus consistent with the objectives of free trade and efficient resource allocation.

10.4 Conclusion

Politically, ASEAN has succeeded in establishing regional stability by helping to overcome traditional sensitivities arising from differences in historical, ethnic, linguistic, and religious backgrounds, defusing border disputes, allaying the fears of smaller nations regarding their larger neighbors' territorial ambitions, and providing the stable underpinnings for each member country to pursue economic development with minimal distraction. There is an emerging sense of an ASEAN community. ASEAN is also widely respected internationally for its moderating influence with respect to many political and economic issues and for its economic success.

However, for the first 25 years, ASEAN's progress in economic cooperation and integration had been less satisfactory, and the level of economic integration was low, except for regional connections to Singapore. To the extent that trade preferences have not promoted the growth of intra-ASEAN trade faster than extraregional trade, discrimination has not been trade diverting and has not imposed welfare loss on traditional trading partners. Whether intra-ASEAN trade liberalization and industrial cooperation have been directly welfare enhancing is debatable. The preferential trade agreement entailed endless meetings of ASEAN economic officials, with limited results. Likewise, industrial cooperation schemes contributed little to the industrial development of ASEAN countries. The growth triangle is more welfare enhancing. And to the

extent that AFTA contributes to the lowering of most-favored-nation tariffs and nontariff barriers and increased investment improves growth performance, the trade creation effects should outweigh the trade diversion effects and regionalism should contribute to multilateralism.

The ASEAN region was the world's most dynamic over the past decade. The economies are expected to remain buoyant over the next decade. However, dramatic geopolitical and economic changes regionally and globally have confronted ASEAN and its economies with several challenges. Regional peace and security is being threatened by the rise of regional powers and territorial disputes in the South China Sea. The purpose of the ASEAN Regional Forum is to defuse such tensions. On the economic front, ASEAN faces intensified regional and global competition for markets and investments. ASEAN countries want to enhance their competitiveness as a production base and investment location. Trade and investment liberalization and facilitation measures under AFTA, AIA, and the growth triangles will help achieve this objective.

AFTA is too small to be inward looking. ASEAN has a population exceeding those of the European Union and NAFTA, but its GNP size is less than 10 percent of each of those two groupings. This has encouraged ASEAN to practice "open regionalism"; some member countries have multilateralized their trade liberalization under AFTA. ASEAN economic cooperation can move beyond AFTA and take advantage of the de facto economic integration process in the Asia Pacific that has resulted from growing trade and investment linkages forged by the private sector. To do this, ASEAN policymakers could reduce barriers to trade and investment flows through liberalization and facilitation measures, encourage their private sectors to be engines of growth, and develop strategic trade and investment linkages with other dynamic economies, subregions, and free trade areas. ASEAN's active participation in the APEC forum and overtures to building linkages with Australia and New Zealand, NAFTA, and Western Europe are building blocks toward multilateralism.

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Comment

Mario B. Lamberte

Chia's paper provides an excellent and objective review of ASEAN's accomplishments in the area of trade and industrial cooperation in the past 25 years, the most recent of which are the ASEAN free trade area (AFTA) initiative and the formation of subregional economic zones or growth triangles.

As accurately pointed out by Chia, AFTA was born without the benefit of the rigorous studies and long discussions that usually precede the birth of trading blocs. The ensuing intense debate carried out in each country on the manner and scope of implementation of AFTA attests to this fact. More recently, some studies have been done to shed light on the effects of AFTA on members'

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economies. It is worth mentioning some of them here to add flavor to Chia's discussion. Using an ASEAN Multi-Country Model to perform a simulation analysis over a seven-year period under AFTA, Yap and Edillon (1993) found that intra-ASEAN trade increased, but that the increase favored only Singapore in terms of an improved trade balance. All ASEAN countries realized a net gain in terms of long-run GDP growth; however, this gain was very modest. Teh (1993) also performed a simulation analysis using a computable general equilibrium model, focusing on the impact of the Common Effective Preferential Tariff (CEPT) on the Philippine economy. His results suggest that the CEPT produces very little resource allocation or efficiency gains for the Philippines as reflected in projected share of trade with ASEAN, sectoral growth rates, income distribution, and pattern of capital or labor allocation across broad sectors of the Philippine economy.

Chia extensively discusses the advantages of the growth triangle over AFTA as a mode of ASEAN economic cooperation. However, it is not clear to me whether she considers growth triangles within ASEAN as a substitute for AFTA or an intermediate step toward AFTA. This is important because even if the financial resources each participating country in a growth triangle commits are small, their economic and social costs and benefits still must be evaluated properly. This is especially important in the case of the BIMG-EAGA, where the major factors that made SIJORI a successful story are less obvious.

ASEAN economic cooperation, of course, extends beyond AFTA and growth triangles. Let me mention existing ASEAN cooperative arrangements in the area of banking and finance, which were not mentioned in Chia's paper. These are the ASEAN Swap Arrangement; the use of ASEAN currencies in intra-ASEAN trade; the ASEAN Finance Corporation; the ASEAN Fund; and ASEAN cooperation in insurance.[1]

The ASEAN Swap Arrangement

This arrangement was established by the ASEAN central banks (excluding Brunei's) in August 1977 to provide short-term swap facilities for member countries with temporary liquidity problems. It operates through swaps of U.S. dollars against the currency of the borrowing ASEAN country. Each member is supposed to contribute $40 million and may borrow up to $80 million. The arrangement is supposed to last for five years. Its success has already prompted the ASEAN central banks to renew it four times. The five ASEAN member countries take turns acting as managing agent.

The arrangement provides a sort of last resort facility for ASEAN central banks. None availed themselves of it in the first few years, and in the past few years ASEAN central banks have had easy access to other facilities. But in times of great need, ASEAN countries have turned to this facility. The Philippines, for instance, availed itself of the arrangement at the height of its balance-

1. The following discussion draws heavily on Lamberte (1991).

of-payments problem. But it has not accessed the facility in the past few years when other financing facilities have become available.

Liberalized Use of ASEAN Currencies in Intra-ASEAN Trade

The idea originated in the ASEAN private banking sector, which proposed that ASEAN governments formally agree to permit ASEAN-based traders to use any ASEAN currency as the medium of exchange for intra-ASEAN trade. There are at least three advantages to this arrangement. First, it will conserve the hard currencies of ASEAN countries and at the same time promote intra-ASEAN trade. Second, it will ensure the supply of critical imports that can be readily supplied by ASEAN countries. And third, it will stimulate the expansion of intra-ASEAN banking activity with increased intra-ASEAN trade flows.

This arrangement was not difficult to forge since two of the six ASEAN countries, namely, Singapore and Brunei, already have liberal foreign exchange policies that allow their traders to use any medium of exchange acceptable to the exporter. In other ASEAN countries, liberalization in the use of ASEAN currencies began in 1987 in response to the proposal of the private banking sector.

The results of the liberalization have been encouraging. All ASEAN countries reported an increasing trend in the use of ASEAN currencies especially in those currencies that had not been accepted before as mediums of exchange. Reports of individual countries showed the following:

Brunei Darussalam. Ninety-five percent of accounts involving ASEAN trade were settled with ASEAN currencies. Available data on the value of intra-ASEAN currency settlements through the commercial banks showed that the Singaporean dollar accounted for 82 percent. But what is notable is the increasing use of Malaysian, Philippine, and Thai currencies in the settlements.

Indonesia. Of the total trade transactions with ASEAN countries, less than 20 percent were settled in ASEAN currencies. The Singaporean dollar was the dominant settlement currency.

Malaysia. Around 23–28 percent of its total receipts and 12–14 percent of its total payments were settled in ringgit. The Singaporean dollar was also widely used as a settlement currency, accounting for 5–7 percent of total receipts and about 10 percent of total payments. The rupiah, baht, and Bruneian dollar were also used to a lesser extent for trade settlement.

Philippines. The available information on the value of intra-ASEAN currency settlements pertains to the Central Bank's over-the-counter purchases of ASEAN currencies. The statistics indicate continuing growth in the use of ASEAN currencies. Still, the Singaporean dollar has dominated. What is more

noteworthy is the significant rise in the Central Bank's over-the-counter purchases of Malaysian, Bruneian, Thai, and Indonesian currencies during the period 1986–89.

Thailand. The proportion of trade settled in ASEAN currencies compared to the value of Thailand's trade with other ASEAN countries rose by 11.5 percent in 1989 against 10.7 percent in 1988.

So far, the available information suggests that with the liberalization in the use of ASEAN currencies, ASEAN countries were able to conserve their hard currencies in intra-ASEAN trade transactions. However, it cannot yet be ascertained whether the arrangement has induced more trade among ASEAN countries.

ASEAN Finance Corporation

The ASEAN Finance Corporation (AFC) is one of the concrete manifestations of regional cooperation within the private banking sector under the leadership of the ASEAN Banking Council. It was set up in 1981 with five ASEAN countries contributing S$20 million each to the initial capital to finance ASEAN industrial cooperative projects and to provide venture capital to ASEAN entrepreneurs. Schulze (1988) has already made a thorough assessment of the AFC, and most of his conclusions still hold today. Specifically, the AFC is generally liquid and is characterized by slow growth. Hence, it is not able to attract more equity funds. It is very much involved in money market activities. The AFC cannot be entirely be faulted for this since there were not enough industrial cooperative projects to support. But other serious weaknesses have been pointed out by Schulze. One is that the conflict of interest between shareholders and the AFC could have resulted in the latter's accepting highly risky but less profitable ventures while the former take the less risky but more profitable ones. Another weakness is that being a private corporation, AFC could not tap cheap sources of funds usually given by donor foreign governments.

ASEAN Fund, Limited

The ASEAN Fund is another project of the ASEAN Banking Council that was recently launched. It is cashing in on the worldwide popularity of mutual funds to raise capital in more developed countries for investment in shares of stocks in less developed countries.

The objectives of the fund are to

1. provide a greater measure of liquidity for ASEAN stock markets,
2. foster the development of unlisted small and medium-sized indigenous companies,
3. enhance visibility of the ASEAN countries, and
4. help promote the respective countries' fund management industries.

To attain the second objective, the fund will invest 20 percent of its initial proceeds in securities of emerging growth companies that are not listed on any securities exchange in ASEAN countries, while the remaining 80 percent will be invested principally in securities that are listed on a stock exchange in the ASEAN countries. The fund therefore provides a vehicle for investors seeking long-term capital appreciation through investments in securities of companies in the ASEAN countries.

The fund is incorporated under the laws of Singapore.

ASEAN Cooperation in Insurance

The ASEAN Insurance Council (AIC), which is composed of the insurance commissioners of ASEAN countries, was established in 1978. Its annual meeting has continuously provided an excellent forum for the promotion of ASEAN cooperation in insurance.

One of the accomplishments of the AIC is the construction of the Unified Forms of Insurance Statistics. The objective of this project is to disseminate information on market conditions and practices prevailing in each member country and to promote intra-ASEAN trade in insurance.

Another important accomplishment of the AIC is the Comparative Study of Insurance and Supervision including Tax Laws on Insurance. The objective of this project is to keep member countries informed of current developments in insurance legislation and regulation. The report contains comprehensive and detailed information on the regulations governing the operations of insurance companies in the ASEAN countries.

The private sector was not to be left out of ASEAN cooperation in the insurance sector. Private companies established in 1982 the ASEAN Reinsurance Pool with three separate pools, namely, a treaty pool (nonmarine), an excess-of-loss pool (nonmarine), and a facultative pool (nonmarine). The objective of the pool was to retain a significant proportion of reinsurance premiums that had been completely captured before by reinsurance companies of non-ASEAN countries. In 1989, it was decided to replace the ASEAN Reinsurance Pool with the ASEAN Reinsurance Corporation to give it greater flexibility. It was incorporated in Singapore with insurance companies in ASEAN as the stockholders.

The governments of ASEAN countries have been providing support to the corporation. In the case of the Philippines, which used to have strict regulations on nontrade (invisible) payments in hard currencies before the 1991 foreign exchange deregulation, the insurance commissioner was given the authority to approve remittance of reinsurance premiums to reinsurance companies abroad.

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Comment Shang-Jin Wei

In this informative and well-written paper, Chia (1) discusses the degree of economic linkage within ASEAN, emphasizing the distinction between "cooperation" and "integration," and (2) advances economic and political economy arguments for growth triangles or subregional integration. I would like to comment on these two parts in turn.

ASEAN as a Bloc

First, as Chia points out in her paper, ASEAN has achieved its objectives as an effective security bloc. I have a slight disagreement with her, however, when she goes on to say that ASEAN should not also be judged by its degree of trade integration. I think that it should, at least partly. After all, it is not the case that ASEAN countries have never tried to establish a preferential trade area or a free trade area. They have more than once. So how integrated are ASEAN countries in terms of trade?

To see the actual degree of trade integration in ASEAN, we could look at the ratio of intra-ASEAN trade to ASEAN members' total trade and how this ratio changes over time. If we do that, we find that that ratio has increased over time. But this ratio is not the best way to address the question. Many things can cause this ratio to change over time, many of which have nothing to do with concerted efforts by the ASEAN countries to increase cooperation in trade. For example, faster economic growth in the region can cause the ratio to rise over time.

A better way to measure integration that can be more plausibly be attributed to collective action is, guess what, a gravity model. To illustrate, let me refer to table 1 of my paper with Jeffrey Frankel (chap. 5 in this volume). This is a panel regression on 1,953 country pairs over the period 1970–90. Let me just note that the adjusted R^2 of the regressions is very high (over 70 percent). Once we control for the contributions of economic sizes, geographic distance, and cultural links, we can add an ASEAN dummy that takes the value of one for

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trade between two ASEAN countries. The coefficient is 1.97, which implies that two ASEAN countries on average trade 600 percent (= exp(1.97) − 1) more than two otherwise identical economies. This is a strikingly large number. If we take into account the possibility that Singapore may be an entrepôt for much intra-ASEAN trade, the estimate is lowered only slightly (from 1.97 to 1.42).

Before we conclude that ASEAN is highly integrated, we should entertain another possibility: East Asia in highly integrated, and ASEAN countries are no different from other East Asian economies. We can test this by adding a dummy for East Asia integration to the regression, and we find that this is indeed the case. Two East Asian economies trade many times more than two random countries outside the region. But once we have controlled for an East Asia effect, ASEAN countries no longer show any additional subregional trade bias.

Hence, there is not a special ASEAN effect in (merchandise) trade. However, this is probably not something to worry about. Some computable general equilibrium (CGE) studies compared two scenarios for ASEAN: (1) ASEAN forms a bloc of its own versus (2) ASEAN joins an East Asia bloc. They found that the latter generates higher welfare for ASEAN. I would venture to suggest that, if we add a third scenario—ASEAN countries liberalize unilaterally—this would provide even higher welfare.

Growth Triangles

My second comment concerns growth triangles. Integration involving subregions of various neighboring countries has not received much attention from academic economists. Therefore, I find Chia's discussion valuable and thought provoking.

Upon some thinking I find myself to have some disagreement with Chia's analysis. Chia is clearly strongly in favor of growth triangles. She argues that growth triangles have advantages over free trade areas (FTAs) both on economic efficiency and political economy grounds. Her paper makes no mention of disadvantages of growth triangles relative to FTAs. I would like to suggest that efficiency gains of growth triangles are probably overrated. On the other hand, growth triangles can and often do play many useful political roles.

To put it strongly, on efficiency grounds, I would suggest that subregional trade integration is almost always inferior to regional integration. Like FTAs, subregional trade integration involves trade diversion as well as creation. Moreover, as subregional schemes involve smaller regions, there will be more diversion and less creation.

Of course, growth triangles involve more than just free trade. They also entertain the promotion of investment, improvement of infrastructure, and coordination of other economic policies. But the basic logic goes through. (As mentioned above, some CGE studies find that it is better for ASEAN to be part of a broader bloc than to be an exclusive bloc of its own.)

To summarize, on economic efficiency grounds, subregional integration or

growth triangles are third best, inferior to global integration (the first best) and regional integration (the second best).

Of course, just as multilateral liberalization is often more difficult politically than regional integration, regional integration is sometimes more difficult than subregional integration. Therefore, there are some good political arguments for growth triangles, as Chia has aptly outlined. One particular role that subregional integration can play is in helping to reduce political risks for politicians. However, we must keep in mind the compromise and trade-off involved in promoting growth triangles. Growth triangles should only be used as a building block or intermediate step toward further liberalization.