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From AFTA towards an ASEAN Economic Community ... and beyond

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1. Introduction

This paper gives an overview of recent developments in the process of Asian economic integration. A large part will focus on the integration initiatives undertaken within the framework of the Association of Southeast Asian Nations (ASEAN). ASEAN was not only the first regional integration arrangement in Asia, it also remains the centre for current and future economic integration initiatives in the wider East Asian region. The progress that has been made by ASEAN's member countries in establishing an ASEAN Free Trade Area (AFTA) will be analysed. Given the important and reasonably successful integration initiatives in other parts of the world, such as the EU and NAFTA, academics and politicians have devoted much attention to the possibilities of both deepening and widening economic collaboration in the (East) Asian region. Ten ASEAN countries already decided to establish an ASEAN Economic Community by the year 2020 and some other countries seem eager to join. We will have a closer look at the recent initiatives taken in this direction. We also devote attention to the role ASEAN plays in the regional monetary integration and co-operation schemes adopted in the region. Empirical tests, using the optimum currency area (OCA) theory, will be reviewed to determine whether a common currency would be beneficial for certain groups or sub-groups of Asian countries. The paper concludes with the authors' thoughts on the viability of a wider East Asian Free Trade Area and East Asian monetary union in the long term and on the role ASEAN would have to play in its establishment.

2. From ASEAN towards AFTA

The Association of Southeast Asian Nations (ASEAN) was established on 8 August 1967, when the 5 original members –Indonesia, Malaysia, the Philippines, Singapore and Thailand– signed the Bangkok Declaration. The association now consists of 10 member states, as successively Brunei Darussalam (1984), Vietnam (1995), Laos (1997), Myanmar (1997) and Cambodia (1999) joined. It is interesting to point out that the ASEAN Secretariat was only established in 1976, right after the end of the Vietnam war and almost ten years after the

establishment of ASEAN itself (Pasadilla, 2004:2). The ASEAN Secretariat is based in Jakarta, Indonesia.

In the beginning, ASEAN primarily pursued political goals, striving for peace and security in Southeast Asia. With hindsight, we can say that ASEAN has indeed largely contributed to the overall stability in Southeast Asia and to a general feeling of trust between the member states. From the late 1970s onwards, ASEAN countries also started to give thought to closer economic collaboration, but tangible achievements as to that remained limited for a long time. Although a Preferential Trading Agreement (PTA) was agreed upon in 1977, its impact was limited: the tariff concessions that ASEAN countries granted within this PTA framework were just too small, or related to products that represented only a marginal proportion of intra-ASEAN trade (Cuyvers & Pupphavesa, 1996:4). At that time, ASEAN countries were not ready to open up yet, mainly due to the development gap that existed between the member states and apparent by the fact that some members scrupulously stuck to import substitution strategies. Moreover, economic growth rates in the region were high anyway, so ASEAN members did not really feel the need to push ahead with trade liberalisation efforts. It was only in the second half of the 1980s that trade liberalisation seriously started to make way in the ASEAN-6¹. By then, ASEAN countries had gained enough self-confidence and also felt the increasing external pressure from the IMF and the World Bank to speed up trade liberalisation efforts. Finally, ASEAN members also wanted to arm themselves against the newly developed trading blocs of NAFTA and the EU, as they were concerned about their exports to these huge markets. (Naya, 2004:3; Naya & Imada, 1992:56; Elliot & Ikemoto, 2004:4). In January 1992, ASEAN leaders decided to take their trade liberalisation efforts to a higher level, by establishing the ASEAN Free Trade Area (AFTA). In 1995 they also concluded the supplementary ASEAN Framework Agreement on Services (AFAS) and in 1998, ASEAN ministers established the ASEAN Investment Area (AIA). Hereafter, we will mainly focus on the AFTA agreement.

The AFTA Agreement went much further than the former PTA, concluded in 1977: the new agreement aimed at reducing tariffs on a large range of products, but also strived for the elimination of non-tariff barriers, quantitative restrictions and other cross-border measures

¹ “ASEAN-6” is often used to designate the six long-standing members of ASEAN: Indonesia, Malaysia, Philippines, Singapore, Thailand and Brunei Darussalam. “ASEAN-CLMV” is used to designate the new (and up to now less developed) members Cambodia, Laos, Myanmar and Vietnam.

(Pasadilla, 2004:4). By eliminating tariff barriers among ASEAN members, AFTA would turn the ASEAN economies into a single production base and would simultaneously create a regional market of 500 million consumers. The AFTA agreement envisioned a staged trade liberalisation, reducing tariff rates levied on intra-ASEAN imports to no more than five percent over a period of 15 years. Tariff reductions only apply to products that comply with the “ASEAN content requirement”. This means that at least 40% of the value of a product must originate in ASEAN countries (ASEAN Secretariat, 1992: CEPT, art. 2.4). According to the original plan, AFTA would be fully established by 2008. However, already in 1994 ASEAN Economic Ministers decided to accelerate the process, advancing the completion date to 2003. In 1995, the target date was advanced further to 2002. At the same time, it was decided that tariffs on intra-ASEAN imports should be completely eliminated by 2010 for ASEAN-6 and by 2015 for ASEAN-CLMV. (ASEAN Secretariat, 2002; Cuyvers & Puppavesa, 1996:6-7; Pasadilla, 2004:3)

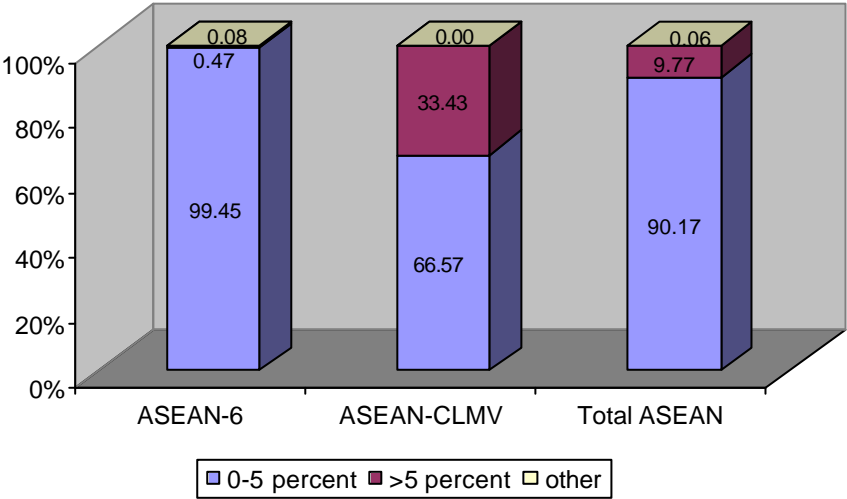
The Common Effective Preferential Tariff (CEPT) Scheme was introduced to implement the AFTA Agreement in practice. The CEPT Scheme encompassed manufactured and semi-manufactured products, including capital goods and processed agricultural products. The liberalisation process was carried out at different speeds according to the product group: distinction was made between a “fast track” scheme and a “normal track” scheme. Products in the Inclusion List (IL) had to be immediately liberalised through a reduction of the CEPT tariff rates to a maximum of 5 % by 2002. The ASEAN-CLMV countries were allowed to apply less stringent deadlines: Vietnam has to meet this objective by 2006, Laos and Myanmar by 2008 and Cambodia by 2010. The AFTA Agreement also allowed for the exclusion of certain “sensitive” products from tariff reduction under the normal or fast track scheme. Therefore, Temporary Exclusion Lists (TEL), Sensitive Lists (SL) and General Exception Lists (GE) were drawn up by all ASEAN members. (ASEAN Secretariat, 1999)

Products in the Temporary Exclusion List (TEL) can be excluded from trade liberalisation for a limited period of time. In the end, all products in the TEL have to be transferred to the Inclusion List (IL) in order to bring tariffs down to a maximum of 5%. The Sensitive List (SL) primarily contains raw (unprocessed) agricultural products. Trade in these products has to be liberalised by 2010 for the ASEAN-6, while the new members get an even more extensive time frame. Products in the General Exceptions List (GE) are permanently excluded from trade liberalisation on grounds of protection of national security, public

morals, public health, environmental protection and protection of articles of artistic, historic or archaeological value. (ASEAN Secretariat, 1999)

More than 99% of the products in the CEPT Inclusion List (IL) of ASEAN-6 now have tariffs of no more than 5% (Figure 1). The small number of products that still have tariffs of above 5%, are mainly products that have been transferred from the Sensitive Lists (SL) and the General Exceptions Lists (GE) in 2003. Moreover, almost all products traded by ASEAN-6 in the region are part of the IL. For ASEAN-CLMV, tariffs on 66.57% of the products in the IL have been reduced to a maximum of 5%. It must be noted, however, that no more than 80% of the products traded by these countries in the region are part of the IL. This all means, that the IL of ASEAN-10 (total ASEAN) now contains about 90% of total tariff lines and that 90.17% of tariff lines in the IL have tariffs ranging from 0-5%. (ASEAN Secretariat, 2004h:16-17; AFTA Council, 2003)

Figure 1: Percentage of Tariff Lines at 0-5 Percent in the Tentative 2004 CEPT Package



Note: “other” represents those tariff lines with specific duties based on data before application of ASEAN Harmonised Tariff Nomenclature (AHTN)

Source: ASEAN Secretariat (2004h:17)

Table 1 reproduces the scheme that was applied for the gradual reduction of the average CEPT tariff rates. The average tariff rate under the CEPT Scheme for ASEAN-10 was at

2.63% in 2003, and ranged from 0% in Singapore to 7.96% in Cambodia, ASEAN's youngest member state. In 2004, the average tariff for ASEAN-6 further decreased to 1.51%, compared to 12.76% in 1993 when AFTA started off. (ASEAN Secretariat, 2004h:17)

Table 1: Average AFTA/CEPT Tariff Rates by Country (%)

	2000	2001	2002	2003
Brunei	1.26	1.17	0.96	0.96
Cambodia	10.40	10.40	8.93	7.96
Indonesia	4.77	4.36	3.73	2.16
Laos	7.07	6.58	6.15	5.66
Malaysia	2.85	2.59	2.45	2.07
Myanmar	4.38	3.32	3.31	3.19
Philippines	4.97	4.17	4.07	3.77
Singapore	0.00	0.00	0.00	0.00
Thailand	6.07	5.59	5.17	4.63
Vietnam	7.09	7.09	N/A	N/A
ASEAN	3.74	3.54	3.17	2.63

Note: the average CEPT tariff rates for ASEAN as a whole are weighted averages, with the number of tariff lines in the Inclusion List for 1999 used as the weights.

Source: ASEAN Secretariat

Although the ASEAN Secretariat claims that AFTA is now virtually established, this statement might somewhat disguise the truth. Rice, considered as a highly sensitive product for the region, is still excluded from the AFTA agreement. Moreover, several members are still very unresponsive when they have to lower tariffs on certain other critical product groups. Malaysia, for example, refused to comply with the AFTA deadlines and kept on levying tariffs on completely built up (CBUs) and completely knocked down (CKDs) automotive units. By doing so, Malaysia undoubtedly wanted to protect its state-controlled carmaker Proton. Only very recently, automotive CBUs and CKDs have finally been transferred to Malaysia's Inclusion List. It goes without saying that Thailand, having a fast-growing automotive industry itself, was not really pleased with this significant delay in Malaysia's liberalisation efforts. (Economist, 2004; AFTA Council, 2004)

The most pressing issue however, is the very limited use of the CEPT Scheme. Calculations show that only 5% of intra-ASEAN trade has been carried out using CEPT tariff rates (Reyes, 2004). Experts say that local enterprises do not bother to go through all the necessary formalities, or just do not know that their business transactions qualify for these preferential tariff rates. The authorities in countries still applying relatively high tariffs, do not bother to inform the local business sector about the CEPT, as they do not want to lose tariff revenues. In other countries, levying relatively low tariff rates, the difference between the CEPT and the ordinary rate is just too small to take the trouble anyway (Economist, 2004).

ASEAN Leaders are trying hard to spread the use of the CEPT Scheme among local business sectors. The CEPT Rules of Origin and its Operational Certification Procedures have been recently revised to better suit the demands of the business environment. The changes include the introduction of (ASEAN Secretariat, 2004a):

- a) a standardised method of calculating local/ASEAN content
- b) a set of principles for determining the cost for ASEAN origin and the guidelines for costing methodologies
- c) a clear and specific treatment of locally-procured materials
- d) an improved verification process, including on-site verification

Up to now, the “value added” method was used to determine origin for products falling under the CEPT Scheme. The value added rule stipulates that at least 40% of the value of a product must originate in ASEAN countries. The Task Force on the CEPT Rules of Origin is currently working on the practical implementation of an alternative criterion in determining origin. The so called “CTH (Change in Tariff Heading) rule” or “substantial transformation rule” will become applicable to products which cannot fulfil the 40% local/ASEAN content requirement (AFTA Council, 2003). The introduction of the alternative “substantial transformation rule” might render the CEPT rules of origin more flexible, especially for the poorer member states, where producers in certain sectors have difficulties to comply with the 40% value added requirement (Brenton, 2003:16).

ASEAN leaders also realise that non-tariff barriers remain a major obstacle in the process of arriving at a free flow of goods within the region. Progress in the elimination of indefensible non-tariff measures (NTMs) remains utterly slow, in spite of the high priority that ASEAN Ministers assign to the matter. Recently, a database on ASEAN NTMs has been set up to get a better overview of the remaining barriers. ASEAN leaders also invited the private sector to

notify all unknown or unlisted NTMs so that they can be eliminated subsequently. Another possible obstacle to the free movement of goods is the divergence of product standards and technical regulations. Therefore, the ASEAN Coordinating Committee on Standards and Quality (ACCSQ) has been made responsible for the implementation of the ASEAN Framework Agreement on Mutual Recognition Arrangements and for the harmonisation of technical regulations and product standards. Finally, all member states are urged to comply with the WTO Agreement on Import Licensing as soon as possible (AFTA Council, 2003 and 2004; ASEAN Secretariat, 2004c).

The ultimate target of any FTA is to arrive at zero tariff rates and to bring about an integrated market with free circulation of goods. The ASEAN-6 countries should accomplish this target by 2010 and the ASEAN-CLMV countries by 2015, according to the AFTA Council (ASEAN Secretariat, 2002). However, as of today, tariffs on no more than 64.12% of products in the Inclusion List of ASEAN-6 have been fully eliminated (ASEAN Secretariat, 2004h:17). It is clear that it will take more time and effort, before a free flow of goods in the ASEAN region is reached.

Apart from the issue whether liberalisation in the region is carried out quickly enough, questions can also be raised about AFTA's contribution to general welfare. Although most authors agree on the positive impact ASEAN has had on the political stability and cohesion in the region, there is less consensus on the economic grounds for the establishment of a free trade agreement in Southeast Asia. Krugman suggested that FTAs between "natural trading partners" are more likely to be welfare enhancing, than agreements between countries that lie scattered. If the regional bias of a particular trading arrangement is too large, trade diversion might, however, exceed trade creation, thus reducing welfare (Krugman, 1991:21-22). AFTA seems a good example of a "natural trading bloc", but it should also be mentioned that ASEAN member countries traditionally have been outward-looking economies. Elliot and Ikemoto rightfully note that inter-regional trade – rather than intra-regional trade – has largely contributed to ASEAN's economic growth during the last three decades or so. Theoretically, AFTA could therefore easily have trade diversion effects (Elliot & Ikemoto, 2004:2).

Some recent empirical studies have analysed AFTA's impact on international trade. The results of these studies are mixed: studies by Elliot & Ikemoto (2004), Gosh & Yamarik (2002) and Cernat (2001) found that AFTA led to net trade creation, while Dee & Gali (2003)

and Soloaga & Winters (2000) suggest that AFTA led to net trade diversion¹. The theoretical expectation that AFTA would have important trade diversion effects, is consequently not fully confirmed by these early studies. Elliot and Ikemoto suggest that the significant inter-regional proportion of total ASEAN trade has been maintained. Even the Asian financial crisis of 1997-1998 has not caused a major change towards inward oriented trading activity of the ASEAN member countries (Elliot & Ikemoto, 2004:16-17).

Intra-ASEAN exports as a percentage of total ASEAN exports increased from 18% in 1985 to 23.16% in 2003, while the share of intra-ASEAN imports in total ASEAN imports went up from 16% in 1985 to 20.73% in 2003. Intra-ASEAN trade seems to grow at a rate that is only slightly above the growth rate of ASEAN's global trade. Moreover, intra-ASEAN trade has increased at a much slower pace than trade among East Asia's developing countries in general. The strong GDP increase in these developing countries and the global move toward trade liberalisation, are the main explanatory factors for this trend. Consequently, ASEAN is not doing overwhelmingly well compared to the wider East Asian region. It is not really surprising then, that ASEAN has turned to its neighbours to revitalise its trading performance, as we will see later on. (AFTA Council, 2004; Naya, 2004:13-14)

It must be noted that the above mentioned studies only focus on the static effects of economic integration, i.e. trade creation and trade diversion. It is clear, however, that the possible dynamic effects of economic integration should not be neglected. Positive dynamic effects occur when barriers to trade are reduced, resulting in a substantial market size increase. Such dynamic effects are e.g., economies of scale, increased efficiency due to intensified competition and increased investments. These effects, in turn, could lead to technological progress, giving ASEAN countries a new competitive edge. As a matter of fact, when ASEAN leaders established AFTA in 1992, they hoped that the free trading arrangement would have a marked positive impact on ASEAN's global competitiveness in the long run. Although these dynamic effects are promising in theory, they have been analysed empirically in only a limited number of studies up to now. As a result, it might be improper to condemn AFTA on its static effects only. (Elliot & Ikemoto, 2004: 17)

¹ The results of these studies were gathered by Coulibaly (Coulibaly, 2004:2).

3. From AFTA towards an ASEAN Economic Community

Asia is not different from other regions in the world. The increase in regionalism in Asia should be viewed from the perspective of a widespread tendency towards regional collaboration initiatives on a world scale. The general deception with the slow pace of liberalisation within the WTO-framework and the idea that regional integration agreements are “building” rather than “stumbling blocks” to global free trade (Bhagwati, 1991:77), has led to a proliferation in the number of regional FTA agreements. Many regional FTAs go even further than what is stipulated by the WTO and are therefore denoted as WTO-plus agreements (Sampson & Woolcock, 2002). It is noteworthy that this movement towards regionalism has already made way in Europe and America, but for Asia it started very recently. (Naya, 2004:4-5)

Even before AFTA was officially implemented in 2003, ASEAN members started talks about further economic integration initiatives. Today, one cannot possibly neglect the manifest regionalism in the East Asian region, as the number of bilateral and plurilateral trading arrangements is increasing month after month.

The 1997-1998 Asian financial crisis is often regarded as the direct cause for the rise in regionalism in Asia. The crisis painfully showed that the East Asian economies were closely related and that de-facto integration in the region had already started much earlier: since the second half of the 1980s, production networks had emerged in the East Asian region, with multinational enterprises splitting up production over the different countries in the region. Multinationals from Japan, and later on also from the Newly Industrialised Countries (NICs), moved some of their production activities to Southeast Asia to take advantage of the cheap labour supply. (Chia, 2004:2; Pasadilla, 2004:5)

Apart from the realisation that their economies were highly interdependent, East Asian leaders also got the feeling that international institutions (especially the IMF) and the main trading partners (the US in particular) fell short in support for the region during the 1997-1998 financial crisis. As a result, East Asian leaders evolved a strong need for formal co-operation agreements and deeper economic integration within the region around the turn of the century. (Naya, 2004:7; Soesastro, 2003:3)

Although the financial crisis might have been the direct cause, one must also look at the broader developments in order to understand the emerging regionalism in East Asia. The end of the Cold War was extremely important in the rapprochement process with former communist states in the region, which have now all become ASEAN members. It is also clear that during recent years, China became much closer to ASEAN. Both China and ASEAN have good reasons for their growing partnership, as we will discuss later. All in all, by the end of the 1990s, the political playing field was sufficiently prepared for further economic integration initiatives in the East Asian region. (Chia, 2004:2-3)

All these forces together have brought about a momentum of both deepening and widening economic integration in East Asia. In December 1997, ASEAN leaders adopted the ASEAN Vision 2020, which can be regarded as a long-term road-map for ASEAN. The plan envisaged the establishment of an ASEAN Community by the year 2020, made up of three different pillars: an ASEAN Economic Community (AEC), an ASEAN Security Community (ASC) and an ASEAN Socio-cultural Community (ASCC). In the Bali Concord II, adopted on 7 October 2003 during the 9th ASEAN summit, ASEAN leaders formally expressed their intention to realise the ASEAN Economic Community (AEC). The AEC is meant to be a single market and production base, with free movement of goods, services, investment, skilled labour and a freer flow of capital. The AEC should also foster equitable economic development in the region and reduce poverty and socio-economic disparities by the year 2020. (ASEAN Secretariat, 1997; 2003a and 2004c)

By creating the AEC, ASEAN endeavours to respond to other regional trading blocs, such as the EU and NAFTA. The recent enlargement of the EU for example, created fears of FDI diversion, i.e. an increasing share of European foreign direct investment flowing into the new member states rather than into ASEAN. Even more challenging is the competition from other low cost producers in Asia, such as China and India. These new economic giants do not only dispose of an abundant supply of cheap labour, but also witness the emergence of an enormous domestic consumer market. By establishing an economic community, ASEAN leaders hope to integrate the national markets of the member states. This integration process should fully take advantage of the diversities in the region to further specialise, to become more efficient and to realise the much needed economies of scale. It is hoped that every ASEAN member will then be able to fully exploit its comparative advantages, leading to a more competitive region as a whole. (Reyes, 2004; Hew, 2003)

The original Hanoi Plan of Action, drawn up in 1998 to serve as a guideline for arriving at the final goal of the AEC, has recently been succeeded by the Vientiane Plan of Action, another six-year plan which focuses on narrowing the development gap within ASEAN and on further deepening regional economic integration. One of the elements of the plan is the establishment of an ASEAN Development Fund, which should foster the development of ASEAN-CLMV countries (ASEAN Secretariat, 2004b). Deeper economic integration will be pursued by the accelerated integration of the following 11 priority sectors: (i) agro-based products, (ii) air travel, (iii) automotives, (iv) e-ASEAN, (v) electronics, (vi) fisheries, (vii) healthcare, (viii) rubber-based products, (ix) textiles and apparel, (x) tourism, and (xi) wood-based products (ASEAN Secretariat, 2004c).

For each of the 11 priority sectors, specific “roadmaps” (ASEAN Sectoral Integration Protocols) have been developed in conjunction with the private sector. These roadmaps indicate the pace of the liberalisation process and the specific timetables that have to be followed up to 2010, in order to facilitate the accelerated integration of these 11 sectors in ASEAN. Import tariffs on products under the priority sectors have to be completely eliminated by 2007 for ASEAN-6 and by 2012 for ASEAN-CLMV. It is noteworthy that these target dates are 3 years earlier than originally foreseen under the AFTA agreement. Similar to the trade liberalisation process under AFTA, a fast track scheme has been developed for accelerated integration towards the AEC, including about 40% of total tariff lines in ASEAN. The decision to accelerate economic integration in these particular sectors is courageous, as the 11 priority sectors together accounted for more than 50% of intra-ASEAN trade in 2003 (ASEAN Secretariat, 2004d). It remains to be seen, however, if the optimistic time frames that were set, will be feasible in practice.

It should be clear by now that flexibility is a distinct property of ASEAN economic integration, with tariff reductions being pursued gradually and differently phased within ASEAN-6 and ASEAN-CLMV (the latter countries are always allowed to apply less stringent time schedules). This flexibility has recently been formalised in the “ASEAN minus X” approach, which means that all ASEAN members have to agree on a specific target to pursue, but individual members can decide to join later, or at the same moment but implementing at a more realistic pace. (Reyes, 2004; Hew, 2003)

ASEAN leaders argue that quick progress in the liberalisation of the 11 priority sectors can serve as an important example for the rest of the economy. However, some major disadvantages to this sectoral approach can be mentioned: when a particular sector is liberalised, thus turning the whole ASEAN region into a single market and production base for this sector, it is clear that tariffs on all intermediate goods used in the sector should also be eliminated. Yet it cannot be excluded that these intermediate goods are produced in other sectors of the economy which are not subject to accelerated liberalisation. Tariffs on vital intermediate goods will therefore remain an important obstacle in the evolution towards a single market and production base for the priority sectors. (Reyes, 2004)

As ASEAN wants to achieve the AEC, it is not sufficient to merely liberalise trade in goods and services. Huge challenges remain before ASEAN meets the other objectives of free movement of investment and skilled labour, and a freer flow of capital. Foreign investors who built up a successful business and consequently want to repatriate their profits, are still disadvantaged by national laws in ASEAN member states that favour domestic investors. It should be clear that other countries like China, are eager to receive these foreign investors. Therefore a profound change in public mindset within the ASEAN region is urgently needed, as foreign investments will benefit ASEAN's consumers in the long run. Some scholars consequently plead for national treatment of foreign investors, both from within and outside ASEAN. As the AEC also envisages free movement of skilled labour, ASEAN leaders will have to come up with clear-cut definitions of skilled labour for each of the 11 priority sectors. Only by using common criteria, national borders for skilled labour will disappear in ASEAN. (see e.g., Reyes, 2004)

In spite of the similar sounding, the structural differences between the proposed ASEAN Economic Community (AEC) and the European Economic Community, which evolved into the European Union (EU), should not be neglected. As the individual ASEAN countries are reluctant to give up national economic policies vis-a-vis non-members, the AEC set-up will not include a common external tariff. This should not be too surprising as one knows that there are huge discrepancies between the member states in average external tariff levels (Economist, 2004). Singapore for example, basically is a free port and does not levy import tariffs. To arrive at a common external tariff, Singapore would consequently have to start levying tariffs or the other nine ASEAN member countries would have to eliminate their tariffs (Reyes, 2004). Moreover, a forced convergence of external tariffs in the short run

would not be wise as the development gap between ASEAN-6 and ASEAN-CLMV is still too large. In the long run convergence would seem desirable, but is seriously hampered by lacking supranational institutional and structural mechanisms (Cuyvers, 2002).

All this implies that ASEAN is not following the example of the EU and rather endeavours to establish a single market without having installed a customs union or having created some supranational authority. This is not really surprising as ASEAN members have always been reluctant to delegate power to some supranational body. In this respect it is interesting to note that ASEAN was established by a declaration and not by a treaty, meaning that ASEAN completely lacks legal personality. The EU on the other hand, does have legal personality and disposes of a powerful Commission to implement and enforce decisions (Cuyvers, 2002; Reyes, 2004). The ASEAN Secretariat in turn, was only established ten years after ASEAN's founding and has been under-powered ever since. Consequently, strong doubts remain whether the ASEAN Secretariat will be able to streamline the integration process towards the AEC (Economist, 2004; Naya, 2004:11-12). It remains to be seen whether the national authorities will enforce compliance with the adopted roadmaps for the 11 priority sectors in practice, given the limited authority of the ASEAN Secretariat (Reyes, 2004).

4. Wider East Asian Economic Integration

ASEAN countries have traditionally been outward looking and they still are today, in spite of the establishment of AFTA. As a result, ASEAN and the ASEAN member states are readily taking part in the recent current of regionalism in the wider East Asian region. Thus ASEAN countries are not only involved in a deepening economic integration process, but also in a widening one. Table 2 gives an overview of the intra-regional and the inter-regional trading arrangements of East Asian countries.

Table 2: Economic Co-operation Agreements of ASEAN members*

	Membership	Status (January 2005)
Intra Regional (East Asia)		
ASEAN: AFTA, AFAS, AIA	ASEAN-10	Implemented

ASEAN-China Comprehensive Economic Co-operation (including FTA)	ASEAN-10, China	Framework Agreement signed in November 2002, Early Harvest Programme implemented
ASEAN-Japan Comprehensive Economic Partnership (including bilateral FTAs)	ASEAN-10, Japan	Framework Agreement signed in October 2003, negotiations on the CEP outline begin in April 2005, Japan-Singapore bilateral implemented, other bilaterals with Japan under discussion
ASEAN-South Korea Comprehensive Economic Partnership (including FTA)	ASEAN-10, South Korea	Negotiations ongoing, negotiations on the FTA outline begin early 2005
China-Japan- South Korea FTA	China, Japan, South Korea	Under consideration, also ongoing negotiations on Japan-Korea and China-Korea bilaterals
ASEAN+3	ASEAN-10, China, Japan, South Korea	Chiang Mai Initiative on monetary and financial co-operation implemented
East Asia FTA	ASEAN-10, China, Japan, South Korea	East Asia Study Group's measures for the establishment of an East Asia FTA adopted, further negotiations ongoing
China bilaterals	with Hong Kong, South Korea, Thailand	China-Hong Kong bilateral implemented, other bilaterals under negotiation
Hong Kong bilaterals	with China	Implemented
Japan bilaterals	with Malaysia, Philippines, Singapore, South Korea, Thailand	Japan-Singapore bilateral implemented, other bilaterals under negotiation
Malaysia bilaterals	with Japan	Ongoing negotiations
Philippines bilaterals	with Japan	Ongoing negotiations
Singapore bilaterals	with Japan, South Korea	Singapore-Japan bilateral implemented, ongoing negotiations with South Korea
South Korea bilaterals	with China, Japan, Singapore, Thailand	Ongoing negotiations
Thailand bilaterals	with China, Japan, South Korea	Ongoing negotiations
Inter Regional		
AFTA-CER Closer Economic Partnership	ASEAN-10, Australia, New -Zealand	Ministerial Declaration September 2002, negotiations on the ASEAN, Australia, New - Zealand FTA begin early 2005
ASEAN-US Enterprise for ASEAN Initiative (including bilateral FTAs)	ASEAN-10, US	EAI announced in October 2002, Singapore-US bilateral implemented, other bilaterals under negotiation
ASEAN-India Comprehensive Economic Co-operation (including FTA)	ASEAN-10, India	Framework Agreement signed in October 2003, negotiations ongoing, Early Harvest Programme will be implemented by April 2005
Asia Pacific Economic Co-operation (APEC)	ASEAN-6, Australia, Canada, Chile, China, Hong Kong, Japan, Korea, Mexico, New Zealand, Papua New Guinea, Peru, Russia, Taiwan, United States and Vietnam	Established in 1989, not a regional FTA as it promotes 'open regionalism', aims to arrive at free trade and investment by 2010 for industrialised members and by 2020 for developing members
China bilaterals	with Chile	Ongoing negotiations
Hong Kong bilaterals	with New Zealand	Ongoing negotiations
Japan bilaterals	with Canada, Chile, Mexico	Ongoing negotiations
Malaysia bilaterals	with US	Ongoing negotiations
Philippines bilaterals	with US	Ongoing negotiations
Singapore bilaterals	with Australia, Bahrain, Canada, Chile / New Zealand ("Pacific Three"), EFTA, Egypt, India, Jordan, Mexico, Panama, Peru, Sri Lanka, US	Bilaterals with Australia, EFTA, New Zealand and US implemented, other bilaterals under negotiation
South Korea bilaterals	with Australia, Chile, Mexico, New Zealand, US	South Korea-Chile bilateral implemented, other bilaterals under negotiation
Thailand bilaterals	with Australia, Bahrain, India, New Zealand, Peru, US	Thailand-Australia bilateral implemented on 1 January 2005, other bilaterals under negotiation

*This table is an updated and slightly adapted version of the table that can be found in Chia (Chia, 2004:5).

As a first initiative towards wider economic integration with important involvement of some East Asian countries, the Asia-Pacific Economic Co-operation forum (APEC) should be mentioned here. APEC grew out of an Australian proposal to enhance co-operation in the Asia-Pacific rim and was formally established in 1989. APEC consists of 21 member countries, spanning four continents and uniting more than one third of the world's population¹. The so called "Bogor goals" express APEC's intentions to achieve free trade and investment in the Asia-Pacific rim by 2010 for industrialised countries and by 2020 for developing countries. APEC pursues trade liberalisation on a voluntary basis, making use of the "open regionalism" concept. This means that reductions of import tariffs are not restricted to APEC member countries, but are granted to all countries world-wide on a most favoured nation basis. (APEC, 2004) Although APEC received a lot of attention in the first half of the 1990s, the attention has faded away and has not revived up to now. The apparent stand-still is due to the large membership, which entails diverging opinions on the pace of trade liberalisation and on the means to get there (Naya, 2004:6).

A negative atmosphere built up around APEC in the aftermath of the Asian financial crisis, as the forum proved unable to manage the crisis and to mobilise decent support for the crisis-hit countries. East Asian countries were disappointed by APEC's impotence and as a result they switched their attention back to the initiatives within the ASEAN and ASEAN+3 (ASEAN + China, Japan and South Korea) framework (Naya, 2004:7). In October 2002, the United States announced the "US Enterprise for ASEAN Initiative", as a framework to negotiate bilateral and plurilateral trade agreements with ASEAN and ASEAN member states. This renewed interest of the United States for the Southeast Asian economies might well give a new boost to APEC's role in managing the international economic relations in the Asia-Pacific rim (Naya, 2004:14).

The ASEAN+3 framework currently seems to be more promising for East Asia than APEC. ASEAN+3 is a more popular name to designate the East Asian Economic Caucus (EAEC), an initiative taken by Malaysia's Prime Minister Mahathir in 1990 to bring together all ASEAN

¹ These member countries are Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan, Thailand, United States and Vietnam.

members on the one hand, and China, Japan and South Korea on the other hand.¹ The ASEAN+3 concept gathered momentum when ASEAN countries wanted to intensify their economic co-operation with Europe in the middle of the 1990s. At that time, the EU proposed to include other East Asian countries in the negotiations, which evidently brought China, Japan and South Korea into the picture. In March 1996, the first Asia-Europe Meeting (ASEM) was held in Bangkok. One year later, the first informal summit of ASEAN+3 leaders was held in Kuala Lumpur, Malaysia (Naya, 2004:5-6). The ASEAN+3 framework booked significant results in the monetary field, when the ASEAN+3 Finance Ministers decided to extend the ASEAN Swap Agreement to China, Japan and South Korea². This new agreement, concluded in May 2000 and better known as the “Chiang Mai Initiative”, of which more in the next section, was an important step towards more financial stability in the region. (Asami, 2001:1)

Despite the Chiang Mai Initiative as a collective ASEAN+3 initiative, it is noteworthy that current negotiations on potential free trade agreements are simultaneously conducted on a bilateral and a plurilateral basis by the countries involved. It was remarkable that China made the first proposal to establish a FTA with ASEAN in 2000. Two years later, in November 2002, the “Framework Agreement on ASEAN-China Comprehensive Economic Co-operation” was signed in Phnom Penh, Cambodia. This agreement envisions a FTA with free movement of goods, services and investments. Tariff reductions on certain agricultural goods have already been started with the implementation of the “Early Harvest Programme”. Tariff reduction for products on the normal track will start in January 2005 and have to be completed by 2010 for ASEAN-6 and China, and by 2015 for ASEAN-CLMV. Tariff reduction for products on the sensitive list will be achieved by mutual agreement. (Chia, 2004:11; ASEAN Secretariat, 2004e)

Both ASEAN and China hope to take full advantage of the new FTA. ASEAN leaders believe that China can play a leading role in boosting economic growth for the East Asian region, which could revitalise the flying geese pattern of economic growth. However, China will remain a formidable competitor for the poorer ASEAN countries in the near future with its relatively abundant supply of cheap labour. It is unlikely that China will soon start making

¹ The original name for the initiative was the East Asian Economic Grouping (EAEG), but was soon renamed into EAEC to get a softer tone.

² The ASEAN Swap Agreement dates from 1977 and was established to support fellow ASEAN members in case of balance of payments problems. See further below.

huge investments in Southeast Asia and will become a supplier of official development aid for the poorest countries in the region. Therefore, China is not ready yet to completely take over the role that Japan has played in the past. (Naya, 2004:8) By means of the ASEAN-China FTA, China hopes to ease ASEAN leaders' concerns of China becoming the single dominating attraction pole of foreign direct investment in the region. Moreover, ASEAN is a promising market with more than half a billion consumers and holds various inputs for further processing in China. (Chia, 2004:11)

Japan quickly followed China's example and proposed a collaboration agreement with ASEAN in 2002. The "Framework Agreement for Comprehensive Economic Partnership" between ASEAN and Japan was signed in October 2003 in Bali, Indonesia. It is important to note that before its 2002 proposal, Japan seemed more inclined to follow the route of bilateral agreements. A bilateral agreement with Singapore had already been signed in January 2002. (Naya, 2004:9) Bilateral agreements with other East-Asian countries such as Malaysia, the Philippines, South Korea and Thailand are still under negotiation. The fact that Japan suddenly also wanted to reach a plurilateral trade agreement with ASEAN as a whole, can therefore reflect Japan's intention to counterbalance China's growing economic and political importance in the East Asian region. Japan now endeavours to integrate its bilateral agreements with the Framework Agreement for Comprehensive Economic Partnership (CEP). Negotiations about the specific articles in the CEP Agreement will start off in April 2005 and are planned to be concluded in two years. (Chia, 2004:12; ASEAN Secretariat, 2004f)

Some ASEAN members are frustrated with ASEAN's slowness in signing deals with China, Japan and other main trading partners. Consequently, they have been pursuing bilateral trade agreements during the last couple of years (Chia, 2004:5; Naya, 2004:11). This evolution fits into the trend of emerging regionalism which can be observed in all parts of the world. Singapore, to only name the champion of bilateralism in the region, has signed bilateral trade agreements with Japan, Australia, New Zealand, EFTA and the US and is negotiating agreements with half a dozen other countries. The current situation seems to reflect the enormous gap that exists within ASEAN, between members wanting to negotiate collectively (using the ASEAN or the ASEAN+3 framework) and other members aiming at quicker progress and thus switching to bilateral trade agreements. The more developed members, such as e.g., Thailand and Singapore, already are relatively open economies and they actually hoped that ASEAN (AFTA) could enhance their global competitive position through further

specialisation and increased FDI inflows. Other (less developed) members are quick to remind the more developed ones that ASEAN should primarily focus on enhancing intra-ASEAN trade and on closing the development gap within ASEAN. These less developed member countries still block the introduction of a “national treatment” rule for foreign investment. It is clear that the views of the more developed countries on the one hand and the poor member states on the other hand cannot be easily reconciled. It is unlikely that the differences of opinion will disappear with the introduction of the ASEAN Economic Community. Thailand and Singapore have therefore turned to the more flexible bilateral agreements, as they can tailor these agreements to open up at the pace they prefer. If the apparent disparities within ASEAN deteriorate, the integration momentum might turn away from ASEAN ... leaving the poorer member states disillusioned. (Economist, 2004)

The question is of course, whether all these bilateral initiatives by individual ASEAN members are undermining the relevance of ASEAN. Two main issues come up. Firstly, if individual ASEAN members all negotiate separate agreements with external partners, it should be clear that the negotiating power of the individual member will be limited. ASEAN as a whole risks to lose the so called “hub-advantages” and the individual countries will gradually become “spokes” (Chia, 2004:12). Secondly, the bilateral agreements could be an obstacle in the evolution towards a region-wide free trade agreement in East-Asia because of the so called “spaghetti bowl” effect (Bhagwati & Panagariya, 1996). This means that in the individual bilateral agreements with non-ASEAN members, diverging rules of origin, product standards and conformance requirements are likely to be applied, thus forming a highly complex structure. This “spaghetti bowl” also makes life more difficult for multinational enterprises, as they have to pay attention to the different regulations in every country. (Chia, 2004:7 and 12)

Up to now, the rules of origin employed within the AFTA framework have been quite liberal, compared with the rules used in agreements of the EU and NAFTA. The 40% ASEAN content requirement is the general principle applied to all products eligible for tariff reduction under the CEPT Scheme, meaning that there are no complex product by product rules of origin. The recent bilateral agreements concluded by individual ASEAN members with external trading partners (such as e.g. the Singapore-US FTA), tend to follow the administrative models of these external partners, thus leading to more restrictive rules of origin. This is exactly the evolution that already took place in the Southern African

Development Community (SADC) (Garay & De Lombaerde, 2004). As the rules of origin start to differ across products and member states, it becomes more complex and costly for companies to make use of the preferential trading arrangements. In that way, the rules of origin might become a hindrance to ASEAN's trade facilitation efforts. (Brenton, 2003:15)

It seems essential to us that the bilateral integration initiatives of ASEAN member states with external partners should be designed to fit into a general ASEAN framework. Only if this condition is fulfilled, bilateral agreements can act as real building blocks for wider East Asian regional integration (Soesastro, 2003:8-9; Pasadilla, 2004:17). The actual idea for a region-wide free trade agreement in East-Asia was put forward by South-Korea during the second ASEAN+3 Summit, which took place in Hanoi, Vietnam in December 1998. The idea led to the formation of the East Asian Vision Group (EAVG), made up of distinguished intellectuals and experts from ASEAN countries, China, Japan and South Korea. The group was tasked to work out proposals on future co-operation in East Asia. In 2001, the EAVG submitted its recommendations in a substantial report, entitled "Towards an East Asian Community: Region of Peace, Prosperity and Progress". The report argued that East Asian countries should strive to establish an East Asian Free Trade Agreement (EAFTA) in the long term. To arrive at this final goal, the ASEAN+3 summit would first have to be transformed into an East Asian Summit. In a next stage, some kind of a new regional institution should arise to guide the integration process towards EAFTA. (EAVG, 2001; Chia, 2004:14; Pasadilla, 2004:6)

In the meantime, the East Asian Study Group (EASG) was formed as a high-level officials committee to assess the EAVG report. The EASG adopted 26 concrete measures on the basis of the report in order to guide the broadening and deepening economic integration process. The short term measures mainly seek to prime general collaboration in East Asia: examples are the development of East Asian think tanks, the promotion of East Asian studies, the establishment of an East Asian Forum and Business Council etc. The long term measures mainly focus on the evolution towards EAFTA. ASEAN leaders already agreed to hold the first East Asia Summit (EAS) in Malaysia in 2005 and also established an expert group to carry out a feasibility study on EAFTA. (ASEAN Secretariat, 2004b and 2004g; EASG, 2002)

5. ASEAN as an engine of monetary integration and co-operation in Asia

Monetary co-operation in Asia has been changing rapidly since the Asian crisis, which started in Thailand on July 2, in 1997, and which triggered severe economic turmoil throughout the region. At that time, the only available monetary co-operation scheme was the ASEAN Swap Agreement (ASA).

In 1977, the central banks and monetary authorities of the ASEAN countries at that time¹ established the ASEAN Swap Agreement (ASA). The aim of the ASA was to provide the member countries with sufficient international liquidity in case of balance of payments problems. US dollars were sold against domestic currency of the requesting participant accompanied by a forward purchase of the same amount of domestic currency by that participant against US dollars. Each participating country agreed to contribute 20 million US dollars, thus providing together 100 million US dollars. The maximum outstanding amount of US dollars received by any participant was not allowed to exceed 40 million US dollars. The original ASA was for a one year period, but was extended in 1978, 1981, 1987 and 1992. In the 1992 ASA (Fifth Supplementary Agreement to the Memorandum of Understanding on the ASEAN Swap Arrangement), the maximum contribution of each participating country was brought to 40 million US dollars, and the maximum outstanding amount received by any participant to 80 million US dollars. In 1997, Laos and Myanmar acceded to the ASA. This was the monetary co-operation framework at the outbreak of the Asian crisis.

At the end of September 1997, and for most observers unexpectedly, Japan proposed the creation of an Asian Monetary Fund (AMF). The largest part of the national contributions to the AMF would come from Japan, but also Hong Kong, Taiwan and Singapore were prepared to contribute, and it was envisaged to reach a total of 100 billion US dollars. In spite of enthusiastic reactions from the Asian countries, the Japanese proposal was blocked by the adverse reactions from major Western countries and from the IMF (see e.g. Lipsy, 2003).

A compromise was sought in the so-called Manila Framework, with a financing agreement that would supplement the IMF financing, but without the institutional component of the AMF. This Framework was developed by the Manila Framework Group in November 1997, which consists of 14 Asia-Pacific nations.

¹ In 1977 these were Thailand, Malaysia, Singapore, the Philippines and Indonesia.

On May 6, 2000, on the occasion of a meeting of the ASEAN+3 Finance Ministers, it was agreed to extend the ASEAN Swap Arrangement to all ASEAN member countries (ASEAN-10) and to China, Japan and South Korea. This agreement is popularly labelled the Chiang Mai Initiative (CMI). It consists of a network of bilateral swap agreements (BSA) between the 13 countries, with the same purpose as the ASA. It was agreed to increase the initial total amount of 200 million US dollars up to 1 billion US dollars. It should be noted however, that this amount is still insufficient to cope with a major financial crisis in the future. Moreover, the use of the currencies of the countries involved in bilateral trade is seriously hampered since the BSA is only adopted by four ASEAN countries, whereas international traders prefer to use the dollar (Tenorio, 2003). The CMI is also more complex than the ASA, due to the multitude of sometimes diverging provisions in the bilateral agreements (Asami, 2001).

In order not to get the same adverse reaction from the USA and the IMF, the BSA is complementary to the IMF, as it was agreed with IMF that at most 10 pct. of a bilateral swap could be done without any link to the IMF, which evidently severely limits the efficiency of the BSA both in terms of timing and conditions attached to support. However, by doing so, the total amount which can be made available for support within ASEAN+3 by the BSA and the IMF is 10 billion US dollars.

In June 2003, the central banks of Australia, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand (the eleven members of the Executive's Meeting of East Asia Pacific Central Banks) announced the establishment of the Asian Bond Fund (ABF). It aims at managing a fund of approximately 1 billion US dollars, which will come from Asian and Pacific countries¹, and invest this fund in a basket of liquid dollar denominated Asian government bonds (Yam, 2003). The Bank for International Settlements's investment management unit, BIS Asset Management, will manage the ABF with teams based in its Representative Office for Asia and the Pacific and in the BIS head office. The ABF will facilitate the re-investment of a small portion of Asia's international reserves back into the region while at the same time aiding the development of regional capital markets. It is clear that the ABF is too small to prevent a new Asian financial crisis, taking into account that the Asian market for dollar denominated bonds is estimated at 200 billion US dollars (Bloomberg, 2003).

¹ It is noteworthy that India alone pledged to contribute 1 billion US dollars; see Yam, 2003.

The issue whether groups and sub-groups of Asian countries could establish a common currency, is much debated in the academic literature, especially since the 1997 crisis, but in spite of some initiatives within ASEAN, hardly of relevance in actual regional politics.

The academic discussion is intimately related to the question which, if any, countries in Asia can be considered as a group as an optimal currency area (OCA). Optimum currency area (OCA) theory is the mainstream theoretical framework for analysing the structural economic factors that determine the net (positive or negative) effect of forming a currency area among countries.¹ Empirical tests based on OCA theory are therefore a good starting point for evaluating the objective economic conditions for monetary integration in (South)East Asia. Whereas in the short run, political considerations and events, alongside other economic circumstances, might well condition or even impose exchange rate choices, OCA theory is particularly relevant in the medium and long run. The predictive power of OCA theory has been empirically demonstrated by authors like Bayoumi and Eichengreen (1998) and Papaioannou (2003). However, Cohen (1998) and others emphasise that the presence of a regional hegemon committed to monetary integration and the presence of a network of linkages and commitments that make the cost of a dependent monetary policy acceptable to all members are also necessary conditions for successful monetary integration. He goes even further stating that the combination of these two conditions might even be a sufficient condition. According to the same author, historical analysis shows that economic linkages are insufficient to sustain the necessary commitment beyond the short run.

What do the empirical tests of the OCA conditions that are available for (South)East Asia tell us? An answer to this question should allow us to understand the economic fundamentals that will shape exchange rate policies and, possibly, the formation of currency unions in the region in the near or farther future, recognising that the institutional framing and, even more importantly, Chinese and Japanese attitudes and leadership will be equally important factors.

According to Bayoumi and Mauro (1999) and Ng (2002), indicators of the degree of shock symmetry show that ASEAN members are less suited than those of the EU, a few years before the Maastricht Treaty, for forming a currency union. Deeper economic integration and a firm political commitment in the region are necessary pre-conditions. According to Ng, shocks in

¹ For recent overviews of OCA theory, see e.g. Lafrance and St-Amant (1999), Mongelli (2002) or Horvath (2003).

Southeast Asia are more strongly correlated than in the EU and external shocks are more strongly correlated than in NAFTA. Indonesia, Singapore and Malaysia show a relatively high degree of correlation of shocks. According to Cohen (2003), the lack of political integration and solidarity, necessary to sustain the needed degree of commitment, is the main obstacle to monetary integration.

Sterner and Skoog (2003) analyse the degrees of openness, the degrees of product diversification, similarities of industrial structure, similarities of inflation rates, degrees of correlation of macro-economic variables for ASEAN-10. ASEAN does not appear to constitute an OCA; ASEAN-3 (Malaysia, Singapore, Thailand) or ASEAN-5 (+ Philippines and Indonesia) could form the core of a monetary union, gradually expanding according to pre-set entrance criteria.

Liang (1999) tested the long-run relationship between the real exchange rates of Hong Kong SAR and PR China. For this pair of countries, the real exchange rates do not share common trends and, therefore, this necessary condition for successful monetary integration is not met.

Cheung and Yuen (2004) found evidence on synchronous output movements in the long run and common business cycles in China, Japan and Korea. According to these authors, the formation of a currency union in Northeast Asia would have net positive effects for the participating countries. They point however to a number of complications related to the implementation of such a currency union, such as the role of a regional hegemon and the difference in development levels between its members, and the consequences for the macro-economic adjustment process.

More empirical studies take a wider set of countries, comprising both East Asian countries and ASEAN member countries, as a starting point. Eichengreen and Bayoumi (1996), for example, conclude that East Asia satisfies the standard OCA criteria as good as EU countries. As arguments against monetary integration, they see the lack of development of the domestic financial systems, and the lack of institutions and political will at the regional level. Similar methodologies but different variables and data sets are used by Yuen (2000), Trivisvanet (2001), Zhang et al. (2002) and Saxena (2003). Starting from a set of countries including ASEAN-5, Japan, Korea, Taiwan, Hong Kong, China, Australia and New Zealand, Yuen (2000) proposes a multi-speed strategy towards monetary integration. Three sub-regional

monetary unions could be formed in an initial phase: Japan/Korea, Taiwan/Hong Kong and Singapore/Malaysia. Other countries could then join one of these unions, which could finally be integrated in a wider East Asian monetary union. Trivisvavet (2001) considers a slightly reduced set with ASEAN-5, Japan, Korea and Hong Kong. It is found that the group has characteristics of an OCA. An optimal scenario with gradualism would imply that the Southeast Asian countries, with the exception of Indonesia but possibly including Korea, form a monetary union, after which the other countries could join later. Zhang et al. (2002) find that the structural shocks affecting ASEAN-5, US, Japan, Korea, Taiwan, Hong Kong and China are less symmetric and have a larger size on average, compared to the EU, although the adjustment speed is faster. No sufficient evidence is found that East Asia forms an OCA. It is not excluded however that smaller subsets of countries might engage in processes of monetary integration. Saxena (2003), finally, finds that most of the countries comprised by ASEAN, Japan, Korea, China and India show positive correlations for supply disturbances and high labour mobility. The countries concerned could form a currency union around the yen, on the condition that the Yen-Dollar exchange rate can be stabilised.

Goto (2003) uses principal component analysis of seven macro-economic variables for Indonesia, Korea, the Philippines, Singapore, Thailand and Japan. A relatively high degree of synchronisation with Japanese variables is observed, which has dramatically increased since the 1990s. Indonesia, Korea, the Philippines, Singapore and Thailand might consider to form a monetary union around Japan.

The policy debate on monetary integration in Asia, seems to be restricted to the ASEAN countries, however. Taking into account the dominant position of the Japanese economy and its currency in East and Southeast Asia, as well as that of China, this is hardly surprising. At the ASEAN Summit on 15-16 December 1998 in Hanoi, Vietnam, one of the proposals endorsed was to conduct a study into the feasibility of establishing an ASEAN common currency. In 2000 an ASEAN Central Bank Forum Task Force was established, which completed the study in September 2003 (Kuang and Singh, 2003). Due to various delays, we had to wait until August 2003 when at its Finance Ministers' Meeting in Manila, the ASEAN countries adopted the Roadmap for Integration of ASEAN regarding capital market development, capital account liberalisation, financial services liberalisation and ASEAN currency co-operation, with a common currency being pursued as a long term objective (ASEAN Secretariat, 2003b). The roadmap for integration of the monetary sector is part of

the measures taken to realise the ASEAN Economic Community (AEC) by 2020. Many observers and policy makers are, however, sceptical whether it will be possible to reach a common currency by then (see e.g. Tenorio, 2003).

6. Conclusions

ASEAN has made significant progress in liberalizing its trade since its inception in 1967. In spite of the great cultural, political, religious and other diversities within the region, AFTA has been virtually completed in 2003. However, it was pointed out in the previous pages that several sensitive products are still not included in the AFTA arrangement. Further liberalisation efforts are required for ASEAN-CLMV countries in particular, as a significant proportion of products they trade is still not part of the Inclusion Lists.

ASEAN countries have always been very sensitive for possible interventions in their internal affairs, but it seems essential that the ASEAN Secretariat is finally strengthened, especially now the member states envision to establish the ASEAN Economic Community (AEC). It remains doubtful whether ASEAN members will push ahead with the necessary reforms to deepen regional economic integration within the AEC scope, if there is no central body in place which can enforce these reforms in some way. Nevertheless, ASEAN members plan to establish the AEC by 2020 as a single market and production base, with a free flow of goods, services, investment, skilled labour and a freer flow of capital.

The emerging Asian regionalism has led to a sharp increase in the number of bilateral and plurilateral trading arrangements during the last couple of years. It is important to remember that such agreements will always remain a “second best solution” to multilateralism in the evolution towards global free trade. In order to avoid that these regional trading arrangements become “stumbling blocks” (Bhagwati, 1991) in the process to wider free trade, it seems advisable to develop a common ASEAN framework for the bilateral trading arrangements pursued by individual ASEAN members. The multiple rules of origin of the different bilateral arrangements might otherwise easily end up as an unfathomable “spaghetti bowl” (Bhagwati & Panagariya, 1996). The abundance of bilateral trading arrangements might in that way hinder the conclusion of the East Asia Free Trade Agreement (EAFTA), including ASEAN, China, Japan and South Korea. The ongoing talks about EAFTA indicate that ASEAN is not

only involved in a deepening economic integration process, but also in a broadening one. As the political will is certainly present in the region and as the first East Asia Summit is already scheduled to take place this year, EAFTA might indeed become reality in the longer term despite some possible set-backs on the way.

The ASEAN countries have also played a major role in several regional monetary integration initiatives, particularly since the 1997-1998 Asian crisis. The original ASEAN Swap Arrangement was deepened and widened towards the new ASEAN members, as well as to Japan, South Korea and China, to become a complex network of bilateral swap agreements between 13 countries. Also the Asian Bond Fund, originally an initiative of Thailand, has further increased both scale and scope for monetary co-operation. However, at present, all talks about a common currency in the region should not be taken too seriously. The policy debate is still restricted to ASEAN, while the regional financial hegemons Japan and China, are not inclined to follow (or take the lead). Viewed from this perspective, as well as judged from the empirical research on optimal currency areas, it is highly doubtful whether ASEAN alone can reach by 2020 a level of monetary integration, comparable to that of the European Union today. Also in this field, the reluctance (if not the plain obstinacy) of the governments in the region to abandon some of their national sovereignty, is bound to remain one of the major stumbling blocks.

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