

Testimony at a Hearing of the Senate Foreign Relations Subcommittee on East Asia and the Pacific, U.S. Senate, September 15, 2005 at 2:00pm.

INDONESIA'S ROLE IN ASEAN AND ITS IMPACT ON US-INDONESIA ECONOMIC RELATIONSHIP

Hadi Soesastro

Executive Director, Centre for Strategic and International Studies (CSIS), Jakarta (Indonesia) and Visiting Professor, Columbia University, New York

Introduction

In the latest US-ASEAN Dialogue held in Washington, D.C. on 28 June 2005, two major proposals were aired. First, that the idea of a “strategic partnership” between the US and ASEAN be developed. Second, that an ASEAN-US Summit be held in 2007 to commemorate the 30th anniversary of the dialogue relationship.

US-ASEAN relations have reached a stage of maturity. In 1977, at the first US-ASEAN Dialogue the focus of the meeting was on such functional cooperation areas as commodities, market access, development assistance, operations of multi-national corporations, transfer of technology, shipping, energy resources development and food security. Over the years the nature and direction of the dialogue relationship have changed. In 1988, it was agreed that cooperation projects would be developed on the basis of mutual interests, comparative advantage in the project area and project sustainability. The private sector was drawn in to play a key role in the development of cooperation and networks to facilitate market driven economic activities.

In 2002, two major initiatives were launched. The first was the so-called ASEAN Cooperation Plan (ACP) to promote cooperation in such areas as information technology, agricultural biotechnology, health, and disaster response. The second was the Enterprise for ASEAN Initiative (EAI) to form a set of bilateral free trade agreements (FTAs) between the US and interested ASEAN member countries. In the same year, a Joint Declaration for Cooperation to Combat International Terrorism was signed, which subsequently led to the formulation in 2004 of an ASEAN-US Work Plan to Counter Terrorism.

The broadening of the dialogue relationship to political and security issues followed the ending of the Cold War. The dialogue addressed the role of the US in maintaining stability in the region, as well as nuclear non-proliferation and regional security issues, developments in the Korean Peninsula and the South China Sea. The US is increasingly engaged with ASEAN in the political and security fields through its active involvement

in the ASEAN Regional Forum (ARF). In addition to the so-called ASEAN Post Ministerial Meeting (PMC), which is attended by the US Secretary of State, there are periodic meetings between ASEAN SOM (Senior Officials Meeting) leaders and the US Assistant Secretary of State for East Asia and the Pacific Affairs.

In the economic field, there are regular meetings between ASEAN Economic Ministers and the US Trade Representative, as well as at the level of senior officials. Interactions amongst the private sectors have also increased through the US-ASEAN Business Council.

Economic relations between the US and ASEAN continue to be vibrant. In 2004, two-way merchandise trade reached \$136 billion, and the stock of US investments in the region amounted to \$88 billion. There are huge untapped opportunities to further promote this economic relationship. For its part, ASEAN has launched the ASEAN Economic Community (AEC) project that would make the region a single market and production base by 2020. Efforts are being undertaken to accelerate the integration of priority sectors. These will create real opportunities for the expansion of trade and investment between ASEAN and the US. The US side has pledged to help in the implementation of the Vientiane Action Plan towards the realization of the AEC.

All these seem to suggest that there is a great deal of substance in the relationship between the US and ASEAN that is worthy of being elevated to becoming a “strategic partnership”. The commemoration Summit in 2007 could put a seal on the establishment of that elevated partnership between the US and ASEAN.

Indonesia’s Role in ASEAN

Strengthening US-ASEAN relations could help strengthen US-Indonesia relations. But in fact, this also works in the reverse direction. In essence the two relationships tend to reinforce each other. Indonesia’s efforts to strengthen ASEAN will in turn help strengthen US-ASEAN relations and this will have a positive impact on the bilateral relationship between the US and Indonesia, particularly in the economic field.

The regional dimension of bilateral Indonesia-US economic relations provides an opening for further improvement of that bilateral relationship. For its part, the US has launched the Enterprise for ASEAN Initiative (EAI) as a vehicle for strengthening trade and investment relations with Southeast Asian nations. This initiative involves the development of TIFAs (Trade and Investment Framework Agreements) and FTAs (Free Trade Agreements) with individual ASEAN countries. The significance of the initiative could go beyond trade and economic relations to strengthen political and strategic relations with the region.

On the ASEAN side it is believed that efforts to promote regional economic cooperation in the wider East Asian and Asia Pacific region are critical to engaging the US. The

APEC (Asia Pacific Economic Cooperation) and East Asian regionalism (ASEAN + 3, namely ASEAN plus China, Japan and South Korea) indeed should be designed to strengthen trans-Pacific economic relations, specifically between the East Asian countries and the US.

In each of these regional arrangements (or processes), ASEAN has played an important role, in large part as a result of the prevailing political configuration in the region, which is the rivalry between China and Japan. As has often been stated, ASEAN is the least objectionable party in the region to take up a leadership role in regional community building. In APEC, since its inception, ASEAN was to act as a co-pilot. It has also occupied the driver's seat in the ASEAN + 3 process.

ASEAN's future is important to regional arrangements in the East Asian and Pacific region, and critical to promoting the region's relations with the United States.

The prevailing wisdom is that Indonesia is the natural leader of ASEAN. Being the largest country in the region, in terms of its geographic extent and population size, gives Indonesia a predominant position in relation to its neighbors. However, perhaps it is the historical factor that has an equally great significance to Indonesia's position in the Southeast Asian region.

The initiative to form ASEAN was part of a package to end Indonesia's policy of *Konfrontasi* (confrontation) against Malaysia, its immediate neighbor. The creation of ASEAN was to symbolize a radical change in Indonesia's foreign policy orientation, from being a revolutionary force to becoming a responsible member of a regional community. This change in foreign policy orientation had a strong domestic source.

Suharto took over the helm of a country that was virtually bankrupt. Rebuilding the economy required a stable and peaceful regional environment. Resources and energies have to be directed to the huge task of national development. The first step was to end the policy of confrontation and to seek ways to improve relations with its neighbors. Beyond this was the idea of creating a stable and peaceful regional order.

The five founding members of ASEAN (Indonesia, Malaysia, Philippines, Singapore and Thailand in 1967, later joined by Brunei Darussalam in the mid 1980s, and in the late 1990s by Cambodia, Laos, Myanmar/Burma and Vietnam, known as the newer members) recognized the strategic challenges they faced from within and outside the region. However, it was not easy for countries in the region to adjust to the new developments. Indonesia under Suharto was no longer seen as a threat to its neighbors. Yet, some of the neighbors maintain their military alliances with the major powers, originally as an insurance against possible adventurous acts by Indonesia. Since the establishment of ASEAN, the existing military alliances gradually diminished in their importance, while they were accommodated by Indonesia.

In fact, the region was not free from potential insurgencies as some other Southeast Asian countries, North Vietnam then, were still in a revolutionary mode. The perceived threat

posed by another revolutionary force, namely China's Communist Party, was another reason for strengthening the region through a comprehensive security approach. Indonesia introduced its concept of *national resilience* to the region, and proposed that ASEAN strives to build its *regional resilience*.

That comprehensive security approach rests on the idea of enhancing regional peace and security through cooperation in the economic and social fields. ASEAN was not meant to be a military pact. In fact, its members refrained from engaging in regional cooperation in matters of defense, so as not to create opposing military and ideological blocs in Southeast Asia. Although the original ASEAN members were anti-Communist in their domestic orientation, they projected to the outside world a non-aligned posture as advocated strongly by Indonesia.

The fall of South Vietnam led to heightened security concerns in ASEAN. Indonesia's Suharto underlined the importance of regional resilience. This meant strengthening regional cooperation and greater efforts to build the national economy. Indonesia maintained open channels with Hanoi during the Indochina wars. When Vietnam invaded Cambodia, and thereby posed a direct threat to Thailand, ASEAN's policy to support Thailand in opposing Vietnam was adhered to by Indonesia. However, Indonesia believed that it should continue to keep its channels to Hanoi open. This policy was misunderstood in many quarters in ASEAN, but in the end proved to be useful in resolving the conflict politically.

Indonesia's leadership in ASEAN has been mainly in the political field. Its efforts to develop ASEAN have clearly demonstrated its willingness to be involved in a regional structure. Indonesia sees this as the most credible way to gain the confidence of its neighbors. In fact, within this regional structure Indonesia has never thrown its weight around. Its political leadership has not been exercised through an assertive posture, dictating the region's policies. It was exercised in terms of crafting regional consensus on many important issues for the region.

Indonesia has not exercised economic leadership in ASEAN as it does not regard itself as a regional economic power. In the first 25 years of its existence, ASEAN's many economic cooperation programs have been disappointing. It was the changed external environment of the early 1990s that brought about significant change in ASEAN economic cooperation. ASEAN leaders agreed to pursue regional economic integration through the ASEAN Free Trade Area (AFTA). Indonesia's agreement was critical, but Thailand's diplomatic efforts made that possible. Indonesia, until then dubbed "Mr. No" for always tending to say "no" to various economic integration plans, suddenly changed its policy and became "Mr. Go" when agreeing to "go ahead" with AFTA in 1992.

Two years later, when chairing and hosting APEC, Suharto further strengthened this policy by crafting the so-called APEC Bogor goals of "free and open trade and investment in the region" in 2010 for developed APEC members and 2020 for developing APEC members. In an interview, Suharto proposed that the end goal for APEC should be

similar to that of AFTA, namely removal of barriers to trade, including reduction of tariffs to 0-5%.

This was followed in 1997 by an ASEAN Vision 2020, which envisaged the creation of “a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investment, [and] a freer flow of capital” As the Indonesian economy was growing rapidly in the first half of 1990s, Indonesia began to participate actively in economic cooperation activities in ASEAN and APEC.

The financial crisis of 1997/1998 virtually put an end to Indonesia’s active regional involvement. Indonesia was the hardest hit by the crisis. It experienced not only an economic and financial crisis, but it came under multiple crises. ASEAN economic ministers rightly decided that the ASEAN economies must continue with their open economic policies in order to be able to overcome the crisis. Yet, political leadership in the region turned inwards. The Suharto government, having been in place for 32 years, fell. It was replaced by a transition government under Habibie, who was not interested in ASEAN. His successor, Abdurrahman Wahid, wanted to promote a Western Pacific Forum, involving Indonesia, the Philippines, Papua New Guinea, Timor Leste, and Australia, instead of ASEAN.

Megawati was initially also not interested in ASEAN. However, since Indonesia was to host the ASEAN Summit in 2003, she accepted the suggestion that Indonesia should again provide leadership in ASEAN. ASEAN was seriously losing its diplomatic clout in the international arena and it had lost its attractiveness to global investors. The foreign policy community in Indonesia thought that Indonesia’s “comparative advantage” lies in providing political rather than economic leadership. It began to air the idea of an ASEAN Security Community to strengthen the region’s cohesion. This was aimed at both enhancing regional peace and security and restoring ASEAN’s diplomatic power.

In 2002, Singapore Prime Minister Goh Chok Tong, aired the idea of an ASEAN Economic Community. Singapore knew that without active involvement by Indonesia this idea would not fly. Its skillful diplomatic efforts led to the adoption of the idea by Indonesia. Megawati, in her Inaugural ASEAN Lecture in 2003, proposed that ASEAN be built on two pillars, the ASEAN Security Community (ASC) and the ASEAN Economic Community (AEC), which will reinforce each other. In October of that year, when Indonesia organized the ASEAN Summit, it crafted an even more ambitious goal for ASEAN, namely an ASEAN Community in 2020. The ASEAN Community now consists of three pillars, to include an additional one proposed by the Philippines, namely the ASEAN Social and Cultural Community (ASCC).

At the same time, ASEAN embarked on a number of bilateral trade and economic initiatives with China, Japan, India, as well as Australia and New Zealand, which involve the formation of FTAs.

Indonesia's challenge today is to provide leadership to realize the ASEAN Community. The new President, Susilo Bambang Yudhoyono, has been encouraged by many in the region to take this up as Indonesia's responsibility.

Indonesia's leadership will again have to be expressed in terms of building regional consensus. This type of leadership should be distinguished from the kind that is aspired by Singapore or Thailand. Their approach is to move faster than the others and in doing so they hope to force others to follow them. This is the essence of the "2+X" formula that they have introduced in ASEAN. This approach could weaken ASEAN's solidarity that, in fact, is ASEAN's greatest asset. There is also the danger that ASEAN be pulled into many directions because of its engagement in a number of FTA initiatives, seemingly without a clear strategy of how it will manage this web of FTAs.

ASEAN and Free Trade Agreements

It all began with the approaches by China. ASEAN on its part initially did not regard free trade areas (FTAs) as a major element in its international economic diplomacy. ASEAN's own economic integration has been the priority since the decision in 1992 to form an ASEAN Free Trade Area (AFTA), which was followed by initiatives in the fields of investment (AIA) and services (AFAS), and a few other measures. Beyond ASEAN, its trade liberalization efforts are directed at the multilateral level, the WTO's Doha Development Agenda. At the regional level, ASEAN members of APEC attempt to continuously improve their Individual Actions Plans (IAPs) under the region's modality of concerted unilateral liberalization towards free and open trade and investment in the region in 2010/2020. The proposal for an East Asia Free Trade Agreement (EAFTA) was presented by an East Asian Vision Group to the ASEAN+3 leaders as a means to realize an East Asian community, but EAFTA is seen as a long-term effort.

In 2001, at the ASEAN-China Summit in Bandar Seri Begawan, China came up with a proposal to establish an ASEAN-China Free Trade Area within ten years. Within one year, at the Summit meeting in Phnom Penh in November 2002, the Heads of State of ASEAN and China were ready to sign a Framework Agreement on Comprehensive Economic Cooperation (CEC), which included a FTA.

There is no doubt that China's proposal essentially was politically motivated, but China and ASEAN both saw the economic significance of the initiative. However, the process appeared to have been driven largely by China. Having participated in a lengthy and difficult process of WTO accession, China has acquired sufficient expertise to negotiate a trade deal. The deal was made attractive for ASEAN with the introduction of an Early Harvest program. China's initiative was immediately followed by a proposal from Japan. This was to be expected as Japan naturally did not want to be left out. Since then ASEAN has been courted by other countries and have entered into an agreement with a few other countries. However, to date there is as yet no ASEAN document that clearly spells out ASEAN's strategy of engagement in FTAs with its trading partners.

ASEAN-China

The ASEAN-China Framework Agreement on CEC contains three elements: liberalization, facilitation, and economic cooperation. In addition it has a provision on the mechanism to implement the Agreement, including a dispute settlement mechanism. The liberalization element covers trade in goods, trade in services, and investment. In the context of liberalization, the Agreement provides for special and differential (S&D) treatment and flexibility to the newer ASEAN members as well as flexibility to address sensitive areas.

The Framework Agreement contains an Early Harvest program that covers all products in chapters 01 to 08 at the 8/9 digit level (HS Code): live animals; meat; fish; dairy produce; other animals products; live trees; edible vegetables; and edible fruits and nuts. Products under this program are divided into three categories for tariff reduction and elimination, but tariffs will have to be brought to zero for all three categories within three years. However, the program allows for an Exclusion List and different timeframes between the ASEAN-6 (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) and the CLMV (newer members – Cambodia, Laos, Myanmar and Vietnam), for whom zero tariffs will be reached in 2010. Initially it was thought that China would offer the Early Harvest program on a non-reciprocal basis, but this turned out not to be the case. Moreover, some agricultural commodities of great interest to ASEAN, such as rice and palm oil, were excluded from the program. Some ASEAN countries (e.g. the Philippines) did not immediately join the program.

Beyond the Early Harvest, tariff reduction and elimination will be pursued along two tracks, the normal track and the sensitive track. Applied MFN tariffs of products listed in the normal track should be gradually reduced or eliminated in accordance with specified schedules and rates over a period from 2005 to 2010 for ASEAN-6 and China, and to 2015 for CLMV. Reduction of tariffs of products in the Sensitive List will be in accordance with mutually agreed end rates and end dates. The number of products in the Sensitive List is subject to a maximum ceiling, also to be mutually agreed upon.

The Framework Agreement was later amended to incorporate the Rules of Origin (ROO) applicable to the products covered under the Early Harvest program. It also included subsequent Early Harvest agreements between some ASEAN members and China, and it clarified the implementation of the provision of the program as well as the terms and conditions for the acceleration of the tariff reduction and elimination through bilateral or multilateral agreements.

The negotiation on the FTA for goods was concluded within a short time. This was a rather ambitious undertaking. Initially the parties could not agree on the maximum number of tariff lines in the sensitive list. However, as political leaders were determined to begin the process of tariff reduction and elimination in 2005, a compromise was struck, and Ministers were able to sign an agreement at the ASEAN Summit in Vientiane in November 2004. This does suggest the importance of setting target dates.

The Agreement on Trade in Goods of the Framework Agreement on CEC, or for short, the ASEAN-China FTA (ACFTA), is only the first portion of a series of agreements to implement the Framework Agreement. At the Vientiane Summit, Ministers also signed an Agreement on Dispute Settlement Mechanism of the Framework Agreement on CEC. They will be followed by an agreement on services, an agreement of investment, and other agreements. It is indeed rather surprising that ASEAN and China were able to produce those two agreements within a short time.

The ACFTA contained the modality for tariff reduction and elimination for tariff lines both in the normal track and the sensitive track. In the normal track there are three sets of schedules. The first applies to ASEAN-6 and China. The implementation will begin on 1 July 2005, when applied MFN tariff rates will be brought down to 20%, 15%, 10% and 5% for tariffs still above 5%. By 2007 they will be reduced to 12%, 8% and 5%, and by 2009 to 5% and 0%, and finally by 2010 all rates will become zero. The second schedule applies only to Vietnam, where all tariffs will be brought down to 0% in 2015. The third schedule applies to Cambodia, Laos and Myanmar, where some tariffs will still be higher than in Vietnam’s schedule, but from 2011 onwards they will be the same.

In addition, agreement was also reached to bring as many tariff lines to the 0-5% range. For instance, for ASEAN-6 and China, by 1 January 2007 at least 60% of tariff lines placed in the normal track must be reduced to 0-5%. However, some “flexibility” is allowed in 2010, whereby up to 150 tariff lines could still have tariffs but should be eliminated not later than 1 January 2012. For the CLMV countries, this flexibility allows for having tariffs on up to 250 tariff lines to be eliminated not later than 1 January 2018.

In terms of tariff lines in the sensitive track, the Agreement subjects the number of tariff lines to a maximum ceiling. Tariff lines in the sensitive track are further classified into Sensitive List and Highly Sensitive List. For ASEAN-6 and China, the maximum ceiling is 400 tariff lines at the HS 6-digit level and 10% of total import value, based on 2001 statistics. The Highly Sensitive List should have not more than 40% of the total number of tariff lines in the sensitive track or 100 tariff lines at the HS 6-digit level, whichever is lower. For CLMV, the maximum ceiling is 500 tariff lines. To note, tariff lines at the HS 6-digit level for the ASEAN-6 countries varies between 5,600 (Philippines) and 10,400 (Malaysia). The number of tariff lines in the Sensitive and Highly Sensitive Lists is shown in Table 1. Applied MFN tariff rates in the Sensitive List must be reduced to 20% not later than 1 January 2012 and to 0-5% not later than 1 January 2018. For CLMV countries, the target dates are 1 January 2015 and 1 January 2020, respectively. In any case, the sensitive track will be reviewed in 2008.

Table 1 ASEAN-China FTA: Tariff Lines in Sensitive and Highly Sensitive Lists (HS 6-digit)

Country	Sensitive	Highly Sensitive
Brunei	66	34
Cambodia	350	150

Indonesia	349	50
Lao PR	88	30
Malaysia	272	96
Myanmar	271	0
Philippines	267	77
Singapore	1	1
Thailand	242	100
Vietnam
China	161	100

The modality for tariff reduction and elimination in this Agreement resembles AFTA's CEPT (Common Effective Preferential Tariff) reduction scheme. Experience in AFTA suggests that this modality does result in reductions in accordance with the schedule and in fact also brings about acceleration in the reduction and the progressive transfer of tariff lines from the sensitive track to the normal track.

The Rules of Origin (ROO) for the ACFTA as stipulated in the Agreement (Annex 3) are as follows: "a product shall be deemed to be originating if: (i) Not less than 40% of its content originates from any Party; or (ii) If the total value of the materials, parts or produce originating from outside of the territory of a Party (i.e. non-ACFTA) does not exceed 60% of the FOB value of the product so produced or obtained provided that the final process of the manufacture is performed within the territory of the Party." In addition the Cumulative Rule of Origin applies provided that the aggregate ACFTA content, i.e. full accumulation, applicable among all Parties, on the final product is not less than 40%. Also, products that satisfy the Product Specific Rules, i.e. products that have undergone sufficient transformation in a Party, will be treated as originating goods of that Party. The ROO in the ACFTA is also similar to that in AFTA. It is relatively simple and quite liberal. In fact, ACFTA should be commended for this, and perhaps is an example of "best practice" in this regard.

It is also to be noted that the ACFTA explicitly adopts GATT 1994 provisions on national treatment on internal taxation and regulation, transparency, BOP safeguard measures. It also abides to the provisions of the WTO disciplines on, among other things, non-tariff measures, technical barriers to trade, sanitary and phyto-sanitary measures, subsidies and countervailing measures, anti-dumping measures and intellectual property rights.

The Agreement on Dispute Settlement centers on arbitral proceedings in case consultations fail to settle a dispute. The Agreement stipulates the appointment, composition, functions and proceedings of Arbitral Tribunals. It enters into force on 1 January 2005. How well this mechanism will function will be known only when it is being used. This mechanism is perhaps more straightforward than the one recently

adopted by ASEAN as part of its efforts to realize the ASEAN Economic Community. The ASEAN mechanism is yet to be tested as well.

The ACFTA might become a model for other ASEAN FTAs, particularly if the partner country is a developing country. It should be noted that while tariff reduction and elimination are scheduled to be completed in 2010 for the ASEAN-6 and China, and 2015 for the CLMV countries, in the case of the normal track, reduction of tariff lines in the sensitive list (to 0-5%) could be extended to 2018 and 2020, respectively. It should be in interest of ASEAN and China to try to accelerate this process. The modality adopted in the Agreement can accommodate this. However, political will has to be there for this to happen. It also should be noted that the ACFTA is only the first step in the implementation of the Framework Agreement. Negotiating an agreement in services and investment may prove to be more difficult.

To conclude on a more optimistic note, it may well be that ASEAN's engagement in FTAs with other trading partners could create a kind of competition amongst the various FTAs that might lead to acceleration of their completion.

ASEAN – Japan

In January 2002, during his visit to Singapore, Prime Minister Koizumi of Japan announced Japan's interest to form an Economic Partnership agreement with ASEAN, which might have a FTA component. Japan has completed a bilateral FTA with Singapore, the Japan Singapore Economic Partnership Agreement (JSEPA), which is the first FTA for Japan. Japan also wants to develop FTAs with individual ASEAN countries on a bilateral basis. It was immediately obvious that Japan was reacting to the earlier move by China towards ASEAN that led to the decision in November 2001 to develop an ASEAN-China Comprehensive Economic Cooperation Agreement.

At the ASEAN-Japan Summit in November 2002, in their Joint Declaration the Heads of State/Governments agreed to implement measures for the realization of a Comprehensive Economic Partnership (CEP), including "elements of a possible FTA," which should be completed as soon as possible within 10 years. A Committee was established to draft a framework for the realization of an ASEAN-Japan CEP.

In October 2003 in Bali, ASEAN and Japan signed a Framework for Comprehensive Economic Partnership (CEP). Both sides agreed to adhere to the following principles:

- (a) The ASEAN-Japan CEP should involve all ASEAN members and include a broad range of sectors focusing on liberalization, facilitation and cooperation activities;
- (b) The integrity, solidarity and integration of ASEAN will be given consideration in the realization of the ASEAN-Japan CEP;
- (c) The Agreement should be consistent with the rules and disciplines of the WTO Agreement;

- (d) Special and differential treatment should be provided to ASEAN members in recognition of their different levels of economic development, and additional flexibility should be accorded to the newer ASEAN members;
- (e) Flexibility should be given to address the sensitive sectors in each ASEAN member and Japan; and
- (f) Technical cooperation and capacity building programs should also be considered.

The above suggests that an ASEAN-Japan CEP will not be too different from ACFTA, except that there will be no Early Harvest program. The Japanese side has insisted that the Agreement should be a “single undertaking”. The negotiations were scheduled to begin in 2005. It remains to be seen whether such a single undertaking could be negotiated within a reasonable time frame. Both sides want to realize the Agreement by 2012.

An Agreement with Japan, being a developed economy, must strictly adhere to Article XXIV of the WTO to cover substantially all trade. There cannot be a long Exclusion List of sensitive items. In contrast, ASEAN and China could avail themselves of the WTO “enabling clause.” Nonetheless, they agreed on limiting the so-called sensitive track to 10% of total import value. The Japanese side has made it known that in their understanding “substantially all trade” also could mean at least 90% of the value of trade. It should also be closely observed whether the ASEAN-Japan CEP will adopt an equally simple and liberal Rules of Origin (ROO) as in AFTA and ACFTA.

The problem is that Japan already has a bilateral agreement with an ASEAN country, Singapore, which has adopted a ROO that is less liberal than AFTA and ACFTA, and Japan has completed similar agreements with Thailand, the Philippines and Malaysia. The CEP between ASEAN and Japan signed in Bali stipulated that schedules of liberalization concessions between Japan and individual ASEAN countries that have concluded a bilateral FTA or EPA (Economic Partnership Agreement) will not be renegotiated and will be annexed to the ASEAN-Japan CEP Agreement. Nothing has been said about the ROO.

Japan has adopted a dual strategy in regard to negotiating free trade agreements with ASEAN, namely with ASEAN as a group and selectively with certain ASEAN countries. The strategy is to move faster on the latter. It has been said that the origin of this dual strategy was bureaucratic, in that METI was championing for an agreement with ASEAN while Gaimusho (Ministry of Foreign Affairs) preferred bilateral agreements. MOFA thought that it would be very difficult for Japan to have FTAs with the CLMV countries.

How Japan will handle this problem in the ASEAN-Japan CEP is unclear. It can make use of the S&D principle to provide a longer time frame for the CLMV countries as in the case of ACFTA. However, since Japan is negotiating bilateral FTAs with most of ASEAN-6, it is likely that the liberalization schedules will be different even amongst ASEAN-6, and that similar agreements with CLMV will be postponed to a later date. The focus of the agreement with CLMV will be initially on facilitation and cooperation. This could suggest that the ASEAN-Japan CEP will essentially be an umbrella agreement for

separate FTAs. It is unclear whether this is consistent with the principle of a single undertaking.

In this sense, the agreement with Japan could be different from the agreement with China. In the ACFTA, ASEAN can act as a “hub”, but in relation to Japan, ASEAN countries could become “spokes”.

ASEAN – India

In 2002 ASEAN and India agreed to enhance economic cooperation and to work towards an ASEAN-India Regional Trade and Investment Area (RTIA). Amongst the ASEAN countries Singapore has been the main promoter of increased economic and trade relations with India.

In October 2003 in Bali the ASEAN and India Heads of State/Governments signed a Framework Agreement on Comprehensive Economic Cooperation (CEC). It entered into force on 1 July 2004. This Framework Agreement is very similar to, and appeared to have been largely inspired by, the ASEAN-China Framework Agreement. It also introduced an Early Harvest program. The Early Harvest program commenced from 1 November 2004, with tariff elimination to be completed by 31 October 2007 for ASEAN-6 and India, and 31 October 2010 for the CLMV countries.

The schedule to liberalization in the normal track will be over a period from: (i) 1 January 2006 to 31 December 2011 for Brunei Darussalam, Indonesia, Malaysia, Singapore and Thailand, and India; (ii) 1 January 2006 to 31 December 2016 for the Philippines and India; and (iii) 1 January 2006 to 31 December 2016 for the CLMV countries. The timeframes for liberalization in the sensitive track have not been specified in the Framework Agreement and will be mutually agreed upon among the Parties.

The ROO negotiation was to be concluded by 31 July 2004, but the deadline has been missed. In fact, the negotiation has been difficult and becomes the main obstacle in the entire process, including the implementation of the Early Harvest. The Indian side has not agreed to adopt ASEAN’s simple and liberal ROO, as applied also in the agreement with China, and the ASEAN side has not been willing to compromise on this.

ASEAN – Republic of Korea (ROK)

Until recently, Korea resisted to take part in the bilateral FTA game with ASEAN. Former President Kim Dae-jung was more interested in promoting the East Asia Community idea. His successor, President Roh, also focuses his attention to initiatives in Northeast Asia, where Korea is to be developed as a business hub. In the end, however, Korea felt that it cannot afford to be left behind by the other Northeast Asian (+3) countries.

A Joint Declaration on Comprehensive Cooperation Partnership (CCP) was signed at the Summit in Vientiane in November 2004. The establishment of an ASEAN Korea FTA

(AKFTA) is seen as “a natural extension of the existing relations as well as a stepping stone to elevate the ASEAN-ROK relationship to a higher and more comprehensive level.”

AKFTA will be similar to other ASEAN FTAs in terms of its comprehensive scope and provision for flexibility to deal with the CLMV countries. The possibility of achieving Early Results will be considered in developing a Framework Agreement. However, the kind of Early Harvest program to be included will not be confined to agricultural products as in the case of the ASEAN-China CEC, but will include manufactured products that are not sensitive to either side. In fact, it might exclude many agricultural products.

The negotiations on AKFTA will commence in early 2005 and completed within two years. While AKFTA was conceived at a much later date than the other FTAs, the intention is to realize it at an earlier date, with a goal of achieving as high a level of liberalization as possible, whereby at least 80% of products will have zero tariffs in 2009, and with consideration for S&D treatment and additional flexibility for the CLMV countries.

AKFTA may well be the Agreement that will drive other FTAs to accelerate their implementation. This could substantiate the point that was made earlier.

AFTA – CER

A linkage between AFTA and CER (Closer Economic Relations between Australia and New Zealand) was established as early as September 1995. This led to the establishment of a High Level Task Force on an AFTA-CER FTA. The Task Force report, *The Angkor Agenda*, was presented to Ministers from ASEAN, Australia and New Zealand on 6 October 2000 in Chiang Mai (Thailand).

It should be noted that the idea of an AFTA-CER FTA was proposed at an earlier date than the ASEAN-China FTA. The AFTA-CER FTA discussions failed to lead to an agreement. The ASEAN side was not ready to embark on this initiative. It was also not launched at a Summit level. Perhaps it was an idea whose time had not arrived. There were sensitivities on the part of ASEAN to engage in a narrow FTA. The ASEAN side demanded that Australia and New Zealand undertake some facilitation and development cooperation efforts as a prerequisite for the negotiation.

In September 2001 the two sides revisited the idea of promoting closer economic relations and endorsed a new Framework for AFTA-CER Closer Economic Partnership (CEP). In September 2002, a Ministerial Declaration on the AFTA-CER CEP was signed. The CEP is regarded as a building block for greater economic integration. The fields of cooperation under the CEP will be broadened to include, but not limited to, promoting and facilitating trade and investment, capacity building, new economy issues and other areas of cooperation.

However, since relations between Australia and some ASEAN countries were rather cool, not much was happening in terms of implementing the CEP agreement. It was only in Vientiane in November 2004 at the ASEAN-Australia and New Zealand Commemorative Summit that the Leaders revived the idea of a FTA between ASEAN and Australia and New Zealand. The Joint Declaration of the Leaders announced the launching of negotiations on a FTA, to commence in early 2005 and to be completed within two years, as is the case of the ASEAN-Korea FTA.

The Annex to the Joint Declaration stipulates the guiding principles for negotiating a FTA. The FTA will be comprehensive in scope. All barriers to trade in goods, services and investment will be progressively eliminated. It should build on members' commitments in the WTO. It also will have a provision of flexibility as in the other ASEAN FTAs. The hope is that the FTA will be fully implemented within 10 years.

The US "Enterprise for ASEAN Initiative"

During the APEC meeting in Mexico in 2002, President Bush announced the Enterprise for ASEAN Initiative (EAI). This Initiative is aimed at strengthening US economic and politico-security relations with Southeast Asia. It has often been interpreted as an initiative to support the US fight against global terrorism.

The Initiative is to develop FTAs between the US and selective ASEAN countries. The US already concluded a FTA with Singapore. ASEAN countries that have concluded a TIFA (trade and investment facilitation agreement) with the US are eligible. Brunei Darussalam, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam now have such agreements with the US.

Thailand is already negotiating with the US, and approaches have been made with Indonesia, the Philippines and Malaysia. The US is also negotiating FTAs with other countries and sub-regional groupings in other parts of the world. It will only negotiate with a country that it regards ready to make significant commitments. In the case of Indonesia, for instance, the US has put some conditionalities, which include the resolution of current trade disputes involving chicken legs exports from the US and the strengthening of intellectual property protection in Indonesia, especially in relation to optical disks.

It remains to be seen in how far the second Bush Administration, and the new USTR, will put their priority on ASEAN. An agreement with the US will bring about more wide ranging reforms domestically in the ASEAN countries. The US will also put greater emphasis on services liberalization. However, US ROO tends to be rather restrictive, especially in such areas as textiles and clothing.

Implications for ASEAN and East Asia

ASEAN has a huge agenda. Its priority is to deepen economic integration amongst its 10 members. This is a major undertaking in view of the big differences in levels of economic

development and economic openness. In 2003, at the Summit in Bali, ASEAN leaders agreed to establish an ASEAN Economic Community (AEC) by 2020. In line with the ASEAN Vision 2020, it is envisaged that the AEC will be a single market and production base with free flow of goods, services, investments, capital, and skilled labor. The AEC remains vaguely defined. ASEAN officials have opted for a pragmatic approach, essentially moving on a sectoral basis. Eleven priority sectors have been selected for fast-track integration. The eleven sectors are: wood-based products, automotives, rubber-based products, textiles and apparels, agro-based products, fisheries, electronics, e-ASEAN, healthcare, air travel, and tourism. A roadmap has been drawn for each sector.

At the same time that ASEAN undertakes its AEC project, it is engaged in forming FTAs with a number of trading partners as briefly described above. Two immediate issues confront ASEAN. First, can these FTAs be completed before ASEAN realizes the AEC? In terms of the plan (intention), ASEAN-Korea FTA will be completed in 2009, ASEAN-China in 2010, ASEAN-India in 2011, and ASEAN-Japan in 2012, all with some built-in “flexibility”, allowing for some countries or some sectors to move slower. However, the AEC is scheduled for completion by 2020. This means that ASEAN members must try to accelerate the implementation of their AEC initiatives. At least the fast-track sectors should be fully liberalized by 2010.

The second issue regards the need for ASEAN to develop a common framework for its extra regional cooperation, particularly in forming FTAs. A common framework would make it easier for the various FTAs (or RTAs – regional trading arrangements) to become building blocks for or to be amalgamated into wider regional arrangements. More importantly, in so doing ASEAN can become a “hub” to drive the process in East Asia through the ASEAN+1 agreements. In addition, a common framework can help reduce tensions between ASEAN members. As some ASEAN members (e.g. Singapore) have moved faster in developing FTAs, there is an additional, practical reason for having a common framework. The Singapore-New Zealand FTA has been referred to as a model for non-restrictive ROO. Bilateral FTAs involving ASEAN members should have harmonized ROOs along lines of Singapore-New Zealand.

Finally, for ASEAN to become a production base, it also needs to minimize business transaction costs by having similar rules and schedules of tariff reduction to ensure use of most efficient supplier. Most important in this regard is the Rules of Origin (ROO), which constitute one of the elements of a common framework. Restrictive ROO constrains sourcing of inputs. New ROO can also change sourcing decisions away from use of inputs from existing partners. In essence, a common ROO can facilitate the spread of full cumulation and the development of regional production networks. In its FTA with the US, Singapore has introduced two new approaches in calculating ROO that takes into account regional production networks. The first is the principle of outward processing that recognizes manufacturing chains and outsourcing. The second is the so-called Integrated Sourcing Initiative (ISI), allowing parts and components produced in Singapore’s neighboring countries as coming from Singapore, but this is limited to certain non-sensitive items only (IT components and medical devices).

Beyond trade in goods, a common framework also needs to be developed for services and investment, and perhaps also competition policy and IPR. Many of these elements form an integral part of the AEC project. This is a tall order, and ASEAN needs leadership in realizing this objective.

Indonesia-US Relations

In assuming a leadership role in ASEAN, should Indonesia be actively engaged in forming bilateral FTAs with ASEAN's main trading partners? This issue might have become less relevant now as ASEAN *as a group* has formed FTAs or is negotiating FTAs with a number of countries, China, Korea, India, and with the CER countries (Australia and New Zealand). In regard to Japan and the US, Indonesia has no other option than to go bilaterally.

Indonesia has extensive economic and trade relations with these two countries. A FTA with these countries would have a major impact, not only in terms of enhancing Indonesia's market access but also in terms of improving its competitiveness due to the economic reforms that it will have to undertake in implementing such binding agreement. The other objective is to increase the country's attractiveness to international investors, especially from the countries with which it has formed a FTA. Furthermore, the agreement could strengthen political and overall relationship with the partner country.

Concluding a FTA with Japan, and especially with the US, will be more difficult than with other countries as the coverage will likely be wider and the commitments will have to be deeper since it will encompass not only cross-border issues but many "behind the border" issues, including domestic regulations.

In the domestic arena, efforts need to be made to gain better understanding of which sectors will benefit most from the FTAs and which ones will be adversely affected by them. The latter will help the government devise necessary measures to lessen the negative impacts of the FTAs. Equally important are efforts to build capacity, especially of the bureaucracy that will be involved in implementing the agreements. The US can provide valuable assistance here, perhaps to be undertaken under the US-Indonesia Trade and Investment Framework Agreement (TIFA) signed in 1997. Domestic adjustments and reforms will have to be undertaken continuously, and perhaps they need to be properly sequenced. It is often the case that bilateral or regional FTAs help promote domestic reforms.

An agreement with the US could have the greatest effect on Indonesia's reform agenda. If properly designed, this will be highly valuable for Indonesia. An Indonesia that is economically stronger and more competitive will be able to provide economic leadership in ASEAN in the efforts to create of a single market and a production base in 2020, if not earlier. It should be in the interest of the US to see the emergence of a strong and economically integrated ASEAN region.