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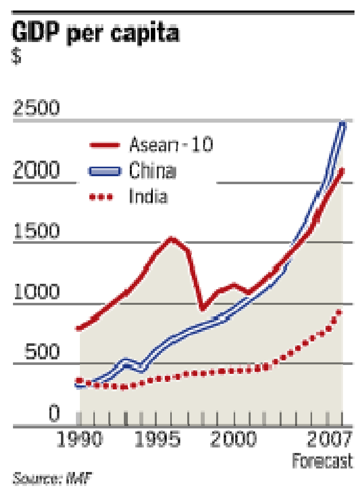
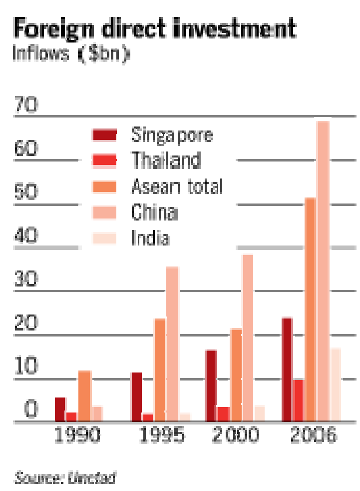
Discomfort zone: a divided Asean struggling to match dreams with reality

By John Burton and Amy Kazmin

The Association of South-East Asian Nations has decided to put some muscles on its puny 40-year-old body. But in signing its first charter when it is already entering middle age, the 10-member group has underscored the task it faces in trying to achieve a European Union-style common market by 2015.

Supporters have compared the approval of the Asean Charter in Singapore to the Treaty of Rome that established the foundation for the EU in 1957. The comparison is double-edged: while Asean is only a decade younger than the EU, it is still struggling to erect much of the organisational framework that has given the latter its cohesion and strength.





The 40-page charter establishes Asean as a rules-based organisation for the first time. The oversight role of Asean's secretariat in Jakarta will be increased, including new systems to monitor compliance and settle disputes. Its drafters describe the document as a framework agreement rather than a constitution, which means that many of the group's powers are left vague.

Asean still lacks a group-wide parliament and court system or the equivalent of the EU Commission. Their absence will do little to convert critics who dismiss Asean as a talking shop that is drifting into irrelevance.

As the charter was being endorsed last week, doubts emerged as to whether it will even take effect. The Philippines has threatened to veto its ratification, rendering the document void, unless Burma, Asean's most troublesome member, shows progress in accepting political reforms. The controversy over the Burmese military junta's recent crushing of the democracy movement reveals emerging splits within Asean even as the group seeks to achieve greater unity.

The region has the potential to exercise economic clout if its efforts towards integration succeed. Its population of 560m is larger than that of the EU and its $1,000bn (£485bn, €674bn) economy is slightly bigger than that of India. South-east Asia remains one of the world's fastest-growing areas, with an average annual economic expansion rate of 5.1 per cent since 1999.

Yet in spite of such advantages, south-east Asia is losing ground to China and India as the favoured destination in Asia for foreign investors. In 1990, the region led Asia in foreign direct investment. It offered cheap production costs and a more welcoming attitude to multinational companies than elsewhere. But the economic reforms that stimulated the growth of China and India, together with their bigger domestic markets, have made south-east Asia less appealing in recent years.

"Asean has to become more integrated and cohesive. Only thus can we keep up with larger and stronger economies such as China and India," Lee Hsien Loong, the prime minister of Singapore, which currently holds the Asean chair, told delegates last week.

The fragmented nature of Asean's internal market is seen as one obstacle to attracting foreign investment. The region is riddled with non-tariff barriers on manufactured goods and there are restrictions on the free flow of services and capital. Intra-Asean trade has averaged around 22 per cent of the total since 1990. By contrast, 70 per cent of EU trade is among its members.

"In terms of supply chains, any barrier to facilitate trade is costing you money. Goods stored at docks [awaiting customs clearance] is the equivalent of a tariff," Susan Schwab, the US trade representative, says in explaining why the US, one of the region's biggest investors, has supported Asean's integration.

In a study commissioned by Asean, McKinsey, the consultancy, predicts that closer integration would add at least 10 per cent to the region's gross domestic product. Under a plan endorsed at the Singapore summit, benchmarks will be established to monitor the compliance of members in fulfilling measures to create a single market in goods, services, investment and skilled labour. Countries that fail to meet deadlines may be required to compensate those affected.

But Asean's history weighs heavily on efforts to achieve pan-regional economic reforms. Asean differs from the EU in that it was not originally an economic grouping but a cold war security organisation intended to counter communist insurgencies in Indochina in the 1960s. The five founding members – Indonesia, Malaysia, the Philippines, Thailand and Singapore – all had anti-communist governments and sought to create a united front to overcome conflicts among themselves.

Only a few years before Asean's founding in Bangkok in 1967, Indonesian and Malaysian troops were fighting one another in Borneo. Singapore had been kicked out of a brief union with Malaysia because the ethnic Chinese city could not get along with the country's ethnic Malay rulers. The Philippines, too, was involved in a territorial dispute with Malaysia.

The group was not taken seriously even by its own members during the early years. Its leaders met only once every five years until 1992, when annual summits were introduced. Under the new charter rules, summits are to be held twice a year to underscore commitment to the organisation's growth.

Given their history of conflict, Asean members agreed from the beginning on a policy of non-interference in each other's domestic affairs. It has remained the group's guiding principle, known as the Asean Way. But it also has been blamed as the prime cause for the organisation's weakness. Its inability to enforce decisions has meant that "only about a third of Asean's agreements have been implemented", says Tommy Koh, Singapore's ambassador at large, calling the record of compliance "unacceptable".

Mr Koh and a group of other regional elder statesmen, assigned to draw up a draft of the Asean charter last year, tried to push for majority voting to replace consensual decision-making and favoured imposing sanctions on members guilty of serious violations to help speed integration. But the move foundered.

The fact that most of the Asean countries have authoritarian governments has made it difficult for them to cede powers to a regional body. One is a military dictatorship (Burma), another an absolute monarchy (Brunei), two have communist governments (Vietnam and Laos) and three are regarded as "managed democracies" (Singapore, Malaysia and Cambodia), with another one (Thailand) perhaps heading in the same direction. Even the region's most vibrant democracies, the Philippines and Indonesia, display strong undercurrents of nationalism.

"EU membership entails sacrifice. But no Asian state, no country, has to do anything to join Asean. Being a member of a true community entails sacrifice," says Michael Montesano, a professor of south-east Asian studies at the National University of Singapore. "The spotty record of democracy in Asean inhibits frank discussion among Asean members."

The addition of Vietnam, Burma, Laos and Cambodia in the 1990s widened economic disparities within the group. The newest and poorest members are reluctant to accept market liberalisation, fearing that they will be left behind as rich members such as Singapore increase their economic dominance in the region.

Cross-border investments by wealthy Singapore have triggered a nationalist backlash in several countries. The purchase of Shin Corp, the leading Thai telecommunications group, by Temasek, the Singapore state investment company, prompted public protests that led to a military coup last year. Indonesia last week ruled that Temasek's investments in two Indonesian mobile operators breached monopoly laws and ordered it to sell one of them, in spite of doubts about the decision's legality.

"How do we consummate this [Asean] marriage? Quite frankly, it's not going to be easy," says Mari Pangestu, the Indonesian trade minister. "Not all business people are gung-ho about Asean economic integration." Some suspect, however, that Temasek was singled out in both cases because it is a sovereign wealth fund; companies in the private sector might confront fewer problems.

Asean's expansion has added other stresses to the group. There appears to be a political divide between Asean's six oldest members and the four newest, as reflected in the internal debate over what to do about Burma. Vietnam, Cambodia and Laos have been vocal in supporting Burma's insistence that Asean should not intervene in its domestic affairs. The dispute is distracting the group from focusing on economic integration. It also raises doubts about Asean's policy of governing by consensus and underscores concerns that it lacks the ability to enforce decisions. Asean is in danger of seeing proposed trade pacts with the US and EU being put on hold unless it takes firmer action against Burma.

Asean faces a dilemma in reconciling two contradictory goals: gaining international legitimacy and maintaining unity, says Hito Katsumata at the S. Rajaratnam School of International Studies in Singapore.

Nonetheless, some think Asean's problems are not insurmountable. The introduction in 2005 of an Asean Free Trade Area, which cut tariffs on local manufactured products, has boosted intra-regional trade. The region is attracting renewed interest from foreign investors. More international companies are deciding that they should not concentrate on putting investments into China but diversify risk by including Asean as well.

Asean still has a competitive edge over China and India in the car and electronics industries, while Asean's per capita income is higher than its bigger neighbours. Although attention has focused on such Asean problems as income disparity, corruption, poor governance and inflexible labour laws, China and India pose the same challenges to foreign investors.

"Asean is by far the most advanced economic organisation in east Asia," says Haruhiko Kuroda, the Asian Development Bank president. He sees integration as achievable if it starts with the easiest measures, such as reducing barriers on trade in goods and investment, before tackling harder issues such as services and capital flows.

The most advanced Asean members are promoting an "Asean minus x" concept in which reforms such as open skies agreements and financial liberalisation could be adopted first by a few countries to gain momentum. "The dual-speed approach is inevitable," says Mr Kuroda. "It's not realistic to expect all to proceed at the same pace, but they all will have to meet the goals by 2015."

Some worry that Asean is paying too much attention to creating a single market while ignoring more important issues. Gempachiro Aihara, head of Asian operations for Mitsui & Co, the Japanese trading house, says his biggest concern is that laws and regulations already on the books are not being implemented properly, which undermines investor confidence.

"A total, completely 100 per cent free trade environment . . . would be hard to achieve," says Mr Lee, the Singapore prime minister. Mr Kuroda agrees, saying that Asean's main goal instead will be to change investor perceptions, which could take a long time. Whether Asean's blueprint for the future is successful will depend on what proves stronger: the region's economic needs or its political imperatives.

NATIONS AIM TO SECURE A STRING OF NEIGHBOURLY ALLIANCES

At its latest annual summit, the Association of South-East Asian Nations adopted the motto: "One Vision, One Identity, One Community". The slogan may come back to haunt the 10-

member group given the scepticism that has greeted its plan to create a single market by 2015 and the political divisions exposed by Burma.

A more appropriate motto might have been "All Roads Lead Through Asean", as the group's other big economic initiative, to become the main hub for bilateral trade pacts in Asia, has been highly successful.

Asean's efforts to negotiate a web of trade deals with China, Japan, South Korea, India, Australia and New Zealand could lay the foundations for the emergence of the world's biggest trading bloc, which would include nearly half the global population and have an annual production capacity of $9,000bn (£4,380bn, €6,080bn). "Just think of it, a free trade area stretching from Hokkaido [in northern Japan] to Invercargill [in southern New Zealand]," says Tim Harcourt, chief economist at the Australian Trade Commission.

Japan last week became the first Asian country to conclude negotiations with Asean on a comprehensive trade deal that covers trade in goods, services and investments. South Korea and China have already signed Asean agreements on goods and services and talks on investments are expected to be completed shortly. Asean officials say they expect similar progress with India, Australia and New Zealand in the next year or two. "Our countries offer complementary advantages to businesses and a neutral core around which the rest of Asia can build economic ties and a regional framework of co-operation," Lee Hsien Loong, Singapore's prime minister, told the Asean summit.

Asean's good record in forging trade alliances with neighbours is perhaps not surprising given that nearly 80 per cent of its total trade goes outside south-east Asia. But Asean also has other advantages. It is the oldest and most developed multinational economic group in Asia, while its rich storehouse of natural resources – from gas and oil to timber – is attracting eager buyers such as China.

"Asean is of strategic importance because of the role it is playing in Asia's economic integration," says Haruhiko Kuroda, the Asian Development Bank president.

More than 40 per cent of Australian exporters think a trade pact with Asean would be beneficial, according to a recent DHL Export Barometer. Australia sees Asean as a growing market for beef, aluminium, crude oil, steel and dairy products.

Akira Amari, Japan's minister for trade and investment, predicts that more Japanese companies will use Asean as a production base under the new agreement. Officials in Tokyo also see a strategic importance in strengthening ties with Asean. As well as gaining greater access to energy, notably Indonesian and possibly Burmese natural gas, Japan is keen to ensure that its southern sea lanes remain open. The prospect of China gaining access to Russian energy and, with it, a stranglehold over continental supply routes, makes Japan even more sensitive to securing the safety of such sea lanes as the Malacca Strait.

But critics warn that while the trade deals are likely to boost economic growth for Asean, they also carry the risk that the region may be relegated to becoming a supplier of raw materials and half-finished goods. China could flood the region with cheap consumer products, wiping out local manufacturers. Malaysia has been forced back into its traditional role as a supplier of palm oil and other commodities as its industrialisation programme has withered under foreign competition.

Moreover, Asean has failed to gain access to the Japanese and South Korean markets for some of its most important products. Although Japan agreed to eliminate tariffs on 90 per cent of imports from Asean countries, it refused to make concessions on rice, sugar and livestock, due to opposition from Japan's powerful agricultural lobby. Thailand opted out in protest over the exclusion of rice from Asean's trade deal on goods with South Korea, which also has a strong farm lobby. India's insistence that up to 1,400 items, including textiles and farm products, should be excluded from its proposed pact with Asean has stymied talks, although a compromise is still being sought.

However, Asean has also won concessions, including the phased dismantling of trade barriers to give local industries more time to prepare for foreign competition. Japan, for example, agreed that Asean's six richest members would have up to 10 years to eliminate restrictions, while the four poorest would have up to 18 years.

With Asean's trade deals with China, Japan and South Korea near conclusion, those three are discussing ways to improve closer co-operation among themselves. "Once all three north-east Asian countries have trade agreements with Asean, sooner or later these should be able to be integrated," says Bark Tae-ho, a professor of international trade at Seoul National University.

An economic grouping in north-east Asia would in turn serve as a main building block for the more ambitious goal of creating a pan-Asian trade zone that would use Asean's bilateral deals as the point of departure.

But the concept has become embroiled in economic rivalry between Japan and China, Asia's two biggest powers: the two are vying to be first to complete a deal with Asean.

A Japanese official expresses concern that some Asean nations are China's "client states". Beijing's influence in Asean has grown due to the relative diplomatic passivity of Japan and what is seen by some as neglect by the US.

China wants to limit the size of the proposed Asian economic zone to Asean and north-east Asia, known as Asean+3. But Japan, fearing that China will dominate the group, has sought to have its democratic allies, India, Australia and New Zealand, join the zone as part of a Asean+6 proposal. Asean agreed last year to study the Japanese plan. "I don't see why we need to place India, with its large market of 1bn people, outside of the territory" to be covered by such a zone, says Mr Amari.

Asean leaders have suggested they will delay proposed trade deals with the European Union and the US until they have made progress on an Asian zone. But Peter Mandelson, the EU trade commissioner, says that would be a mistake.

He maintains: “The Asean economies have great economic potential but they are in danger of failing to realise that potential if they don’t look to the rest of the world as well as their own neighbourhood.”

Additional reporting by Mure Dickie, Anna Fifield, David Pilling and Peter Smith