THE POLITICAL ECONOMY OF THE ASEAN FREE TRADE AREA:
The Dynamics of Globalisation, Developmental Regionalism and Domestic Politics

by

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A thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy in Politics and International Studies

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August 2001

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ABBREVIATIONS

ABL-72	Alien Business Law, 1972 *(Thailand)*
AEM	ASEAN Economic Ministers
AFAS	ASEAN Framework Agreement in Services
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
AICO	ASEAN Industrial Cooperation
AIJV	ASEAN Industrial Joint Ventures
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BBC	Brand-to-Brand Complementation
BPPC	Clove Support and Marketing Agency *(Indonesia)* (*English translation)*
BULOG	National Logistics Agency *(Indonesia) (English translation)*
CBU	Completely Built Up Units
CEPT	Common Effective Preferential Tariff
CKD	Completely Knocked Down Units
CSIS	Centre for Strategic and International Studies *(Indonesia)*
DSM	Dispute Settlement Mechanism
EFTA	European Free Trade Area
EMU	Economic and Monetary Union *(of the EU)*
EU	European Union
FDI	Foreign direct investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GLC	Government-linked corporations *(Singapore)*
HS	Harmonised System
IMF	International Monetary Fund
IPE	International Political Economy (the scholarly field of study)
IR	International Relations (the discipline)
ISIS Malaysia	Institute of Strategic and International Studies, Malaysia
M&A	Mergers and acquisitions
MAI	Multilateral Agreement on Investment
MERCOSUR	Southern Cone Common Market *(English translation)*
MFN	Most-favoured nation
MNC	Multinational corporation
NAFTA	North American Free Trade Area
NEP	New Economic Policy *(Malaysia)*
NIEs	Newly Industrialising Economies
NTBs	Non-tariff barriers
OECD	Organisation for Economic Cooperation and Development
PAP	Peoples' Action Party *(Singapore)*
PAS	Pan Malaysian Islamic Party *(Malaysia) (English translation)*
PE	Polyethylene
PNB	National Equity Corporation *(Malaysia) (English translation)*
PP	Polypropylene
PVC	Polyvinyl chloride
SEM	Single European Market

SEOM	Senior Economic Officials Meetings
TEL	Temporary Exclusion List
TNC	Transnational corporation
TRIMS	Trade-related investment measures
UK	United Kingdom
UMNO	United Malays National Organisation *(Malaysia)*
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
VDP	Vendor Development Programme *(Malaysia)*
WTO	World Trade Organisation

ACKNOWLEDGEMENTS

Many people have made this dissertation possible. For his guidance and encouragement throughout my PhD, my special thanks to Richard Higgott, my supervisor. I am particularly grateful for his patience in allowing me the intellectual space to explore varied lines of research, and for wisely guiding me back whenever I strayed too far. My research also benefited enormously from my association with the Warwick/ESRC Centre for the Study of Globalisation and Regionalisation (CSGR).

Additionally, I wish to express my gratitude to the UK Foreign and Commonwealth Office, which, through its Chevening Award, provided full funding for my three years of PhD research. I would also like to record my appreciation to the Institute of Strategic and International Studies (ISIS) in Malaysia for granting me leave from work to read for the PhD.

A number of research institutes in Southeast Asia also greatly facilitated my fieldwork. ISIS Malaysia in Kuala Lumpur and the Centre for Strategic and International Studies (CSIS) in Jakarta kindly hosted my research visits to Malaysia and Indonesia respectively. My thanks, too, to the Library of the Institute of Southeast Asian Studies (ISEAS) in Singapore for its welcome and the help extended to me. I am also indebted to Mr Mushahid Ali of the Ministry of Foreign Affairs, Singapore (currently with the Institute of Defence and Strategic Studies), for his help in arranging appointments with senior government officials in Singapore.

To the 29 people who graciously consented to be interviewed for this dissertation, I would like to extend my deepest gratitude. Their patient and candid responses to my myriad questions helped me considerably in interpreting the dynamics of AFTA although they may not fully agree with the views expressed in this dissertation, which are, of course, entirely my own.

Good friends played an especially critical role. I am deeply indebted to Cho Kah Sin of the ASEAN Secretariat who was not only instrumental in securing all my appointments for me at the ASEAN Secretariat, but was a very generous host as well in Jakarta. Susan Teoh, Director of the ISIS Malaysia Library, went out of her way to help me fill in the gaps in my references, responding with patient good humour to my e-mail pleas during the final writing up.

I benefited from discussions with Chris Hughes, while Diane Stone helped me gain better insights into my own research topic by inviting me to collaborate with her in writing on Southeast Asian think tanks and regional cooperation. Participants at the May 2000 Graduate Students' Workshop at the University of California, San Diego provided useful feedback on portions of my dissertation.

If writing the dissertation was less onerous than I had initially feared, it was largely because of the company of fellow students and colleagues at Warwick – Liliana Pop, Fernanda Tuozzo, Paola Robotti, Shigeko Hayashi, Hitesh Patel, Titipol, Fransisco Huanacune, Denise Hewlett, Domenica Scinaldi, and Jill Pavey. Lee Hock Guan, Khalid Mehta, Patrick Pillai and Ong Hong Cheong in Singapore and Kuala Lumpur took time to write humorous letters and keep me up-to-date with developments back home.

I am deeply grateful to my dear friend, J N Mak, for his constant friendship and unfailing support. My sister, Anita, and her family – Jose and baby Alexander – provided me with a 'home away from home' in London where I spent many happy hours, the memories of which will always remain with me. My final thanks go to my parents, Victor and Esther, whose work as teachers inspired a lifetime love of learning, and for their total encouragement for this, and all my other quests in life.

DECLARATION

This dissertation is my own work, and has not been submitted for a degree at another university. Material from Chapter 6 in the dissertation was earlier published in April 2001 as a book chapter titled, 'Cooperation and Institutional Transformation in ASEAN: Insights from the AFTA Project' in Andrew T.H. Tan and J.D. Kenneth Boutin (eds) *Non-Traditional Security Issues in Southeast Asia*, Singapore: Institute of Defence and Strategic Studies, 2001, pp. 197-226.

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August 2001

ABSTRACT

This study examines how the interaction between globalisation and domestic politics shaped the evolution of the ASEAN Free Trade Area (AFTA) between 1991 and 2000. Previous studies have argued that AFTA, a project of open regionalism, was adopted to attract foreign direct (FDI) investment to the region. Accurate to a degree, this dissertation argues that the concern with FDI is only part of the AFTA story, albeit an important part. The FDI explanation is unable to explain why market access and national treatment privileges were offered to national (domestic) investors from the ASEAN countries at least ten years ahead of foreign (non-ASEAN) investors in AFTA's investment liberalisation programme.

The dissertation explains this departure from open regionalism, which has yet to be accounted for in the literature, by advancing the notion of 'developmental' regionalism. Underwritten by strategic trade theory rather than neoclassical economics, developmental regionalism emphasises the nurturing of domestic capital by using the expanded regional market and temporary protection or privileges for domestic capital as the means to build up domestic firms capable of meeting global market competition. Unlike existing models of the globalisation-regionalism relationship, which do not integrate domestic politics or do so in a limited way, the model of developmental regionalism considers domestic capital to be a key analytical variable, and takes seriously its location within domestic politics and society.

Using documentary research and elite interviews, and guided by these theoretical insights, the study shows that AFTA encompasses the features of *both* open and developmental regionalism due to the political significance of *both* foreign and domestic capital in the ASEAN economies. While both forms of regionalism were driven by the imperative of growth, distributive concerns were weaved into the concern with growth in developmental regionalism, as governments sought to nurture those segments of domestic capital that were important in sustaining elite rule.

INTRODUCTION

1. The Research Problem

When the leaders of the Association of Southeast Asian Nations (ASEAN) formally announced their decision to form the ASEAN Free Trade Area (AFTA) in January 1992, ASEAN watchers did not expect the project to advance beyond the slow pace and limited scope originally envisaged for AFTA (Australia, 1994: 45).[1] The project was initially designed to lower tariffs on manufactured goods and processed agricultural products to between 0-5 per cent by 2008 over a 15-year period. The decision by the member governments of the core ASEAN states to form AFTA, even in its initially limited form, surprised ASEAN watchers, scholars and even the business community who were not consulted by governments prior to the AFTA decision (Stubbs, 2000: 304). Incidentally, the core members of ASEAN, who are also the founding members of AFTA, are defined to include Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand.[2]

The economic incentives of AFTA were regarded as far from overwhelming to sustain the regionalist project (Means, 1995; Ravenhill, 1995: 866; Dixon, 1999: 124; Mattli, 1999: 169). The move to form AFTA among countries that were not 'natural trading partners' and that were, instead, far more closely linked through trade and investment flows with countries outside the ASEAN grouping was felt to be essentially unsound as it would lead to substantial trade diversion (Ariff, 1994).[3] Moreover, the AFTA project was expected to

[1] ASEAN was formed in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Brunei joined the grouping in 1984 on its independence from Britain. Vietnam joined in 1995, Laos and Myanmar in 1997, while Cambodia joined the Association in April 1999, bringing ASEAN's total membership to ten.
[2] The new members of ASEAN acceded to all AFTA agreements on joining the Association.
[3] Intra-ASEAN exports among the six core members in 1990 stood at about 20 per cent, while their exports to the industrial countries totalled 58 per cent of total exports. Data calculated from the IMF, *Direction of Trade Statistics Yearbook 1996*.

involve substantial distributional implications both within and between member countries, which many believed would lead to the project's eventual collapse (Ariff, 1994: 20; Means, 1995; Low, 1996: 201-2; Ravenhill, 1995: 866; Dixon, 1999: 124; Mattli, 1999: 169).[4] The widely held perception that AFTA was unlikely to advance significantly did not appear to be misplaced in view of the setbacks experienced in AFTA during its initial years and the disputes between member countries that emerged during the project's course.

Yet, AFTA has not merely persisted, it has been accelerated and its scope expanded. AFTA is now due for completion by 2002/2003 when tariffs on all manufactured products and processed agricultural products will be at the 0-5 per cent level while a zero tariff ASEAN is due in 2010. In addition, the scope of AFTA has been expanded to include unprocessed agricultural products, services, and investment. The ASEAN countries pledged to go beyond their World Trade Organisation (WTO) commitments in agriculture and services while ASEAN's attempt to develop a regional regime for investment liberalisation goes beyond the Trade Related Investment Measures (TRIMS) agreement negotiated under the General Agreement on Tariffs and Trade (GATT). Thus, AFTA soon became a composite project of ASEAN economic regionalism comprising three component programmes. The Common Effective Preferential Tariff (CEPT) scheme governed liberalisation of goods trade, the ASEAN Framework Agreement on Services (AFAS) governed liberalisation of services trade, and the ASEAN Investment Area (AIA) scheme governed investment liberalisation.

[4] The inability to address distributional considerations and place regional interests over narrow, national interests was cited as a major reason for the failure of ASEAN's first venture into economic cooperation during the 1970s and 1980s. See Chng (1985: 52) and Tongzon (1998: 64).

Despite these advances in the commitments made, implementation has had mixed success. On the one hand, tariff reductions on manufactured goods were essentially on schedule. Since 1994, tariffs were progressively lowered under the CEPT programme of annual tariff reductions. In the tariff reduction package for 2000 submitted by these countries, almost 90 per cent of the total tariff lines were already in the 0-5 per cent band. In addition, many of the tariff reductions negotiated under AFTA were extended to products originating from non-ASEAN sources, seemingly making AFTA an exercise in 'open regionalism'.[5] On the other hand, petrochemicals in the Philippines and most notably automobiles in Malaysia remain excluded from the CEPT schedule of tariff liberalisation, ostensibly for a temporary period of time although all manufactured goods had been scheduled to come under AFTA disciplines from 2000. The deadline for trade liberalisation in key unprocessed agricultural products was also pushed back to 2010 from the original 2003 deadline while a number of exceptions to the end tariff rate of 0-5 per cent were allowed for particular agricultural items. Negotiations in services liberalisation have been slow, especially in the financial services and telecommunications sectors.

Apart from the more cautious approach to AFTA in these areas, the other significant development concerns the distinction made in the investment liberalisation programme between ASEAN and non-ASEAN investors. The ASEAN member governments pledged to extend national treatment and market access to ASEAN investors by 2003 in the manufacturing sector and 2010 in other sectors, while offering these concessions to all foreign investors only in 2020. In other words, while trade liberalisation in goods may be characterised by open regionalism, the same cannot be said of liberalisation in investment.

[5] The notion of 'open regionalism' is discussed in Chapter 1.

How do we interpret these rather ambiguous trends in AFTA? It is important, in this context, to recognise that unless coerced, national governments are not compelled to make international commitments that do not conform to their interests (Chayes and Chayes, 1993: 179). Thus, it is reasonable to assume that the ASEAN governments had agreed to participate in AFTA and to expand its scope because it was in their interests to do so, however those interests may be defined. The fact that the ASEAN member governments agreed to ambitious commitments, especially on potentially contentious items, is in itself significant irrespective of the implementation record. It indicates the desire or willingness of these governments to submit these areas to joint decision-making. In any case, disjuncture between commitments and implementation is not uncommon in international cooperation, and this is usually attributed to changing domestic political dynamics or because external conditions change (Chayes and Chayes, 1993: 195-201; Yarborough and Yarborough, 1992: 80; Lipson, 1991: 518). If the ASEAN member governments were not forced into accepting AFTA, and implementation is problematic, we also need to ask why this is the case and how member governments sought to overcome these problems.

Key Research Questions

These developments in AFTA between 1991 and 2000 raise at least three empirical questions that guide the dissertation's analysis of AFTA. First, why did the ASEAN countries, already committed to open trade and investment regimes since the end of the 1980s and which were already trading extensively worldwide and participating in international investment flows engage in forming a regional free trade area? Second, how do we interpret the discriminatory treatment between ASEAN and non-ASEAN investors in the regional investment liberalisation programme? If, as the current literature on AFTA suggests AFTA was motivated by the desire to attract global investment capital, then the privileging of ASEAN investors over global investors is rather puzzling. Third, what accounts for the subsequent shift to a more cautious programme of liberalisation in sectors like agriculture, petrochemicals, automobiles and services? Was the initial scepticism about the long-term viability of AFTA borne out by such developments?

AFTA as part of the worldwide resurgence of regionalism

While AFTA certainly represents a novel development for ASEAN, [6] it is also important to remember that AFTA is part of a worldwide resurgence of economic regionalism beginning from the mid-1980s that followed almost two decades of a decline in the phenomenon (Fawcett and Hurrell, 1995: 1). The revival of regionalism began with the decision by the European Community in the mid-1980s to forge ahead with the completion of the Single European Market and to engage in European Economic and Monetary Union (EMU). A second notable shift towards regionalism occurred in North America when the United States, Canada and Mexico successfully negotiated the North American Free Trade Area Agreement (NAFTA) in 1992. A plan for hemispheric economic cooperation between North American and Latin American countries through the Enterprise of the Americas Initiative soon followed, while existing regionalist projects in Latin America were revived and others, notably the Southern Cone Common Market or MERCOSUR, newly created.[7] There was also a new momentum towards economic cooperation in the Asia Pacific Region through the formation of Asia Pacific Economic Cooperation (APEC)[8] in 1989, while the ASEAN countries decided to form AFTA in

[6] Economic cooperation is not a new agenda item for ASEAN, having been first initiated in 1976. It has, however, enjoyed very little success until the advent of AFTA. Moreover, the decision to adopt AFTA was unprecedented for ASEAN, since ASEAN members have, with the exception of Singapore, always been averse to the idea of forming a regional free trade area. Comprehensive discussions of ASEAN economic cooperation between 1976 and 1990 are found in ASEAN Secretariat (1997a: 1-88); Frost (1990: 7-14); Suriyamongkol (1988); and Chng (1985).

[7] The Treaty of Asuncion creating MERCOSUR was signed between Argentina, Brazil, Paraguary and Uruguay in 1991. On the other regionalist projects in Latin America, see Grugel (1996).

[8] APEC groups together the United States, Canada, Mexico, Chile, Australia, New Zealand, Papua New Guinea, China, Japan, Hong Kong, Taiwan, South Korea, the six core ASEAN members,

1991. These were notable events in the regional political economy of the Asia Pacific, given regional governments' long aversion to formal multilateral economic cooperation. Even in parts of the world like Africa where regionalism had for long been discredited, African leaders began urging the formation of regional groupings.[9]

The revival of economic regionalism in so many different parts of the world at roughly the same time points analysis towards broad international level factors (Fawcett and Hurrell, 1995: 3). Globalisation, more specifically, has been cited as the principle driving force of contemporary economic regionalism (Oman, 1994; Gamble and Payne, 1996: 249-50; Higgott, 1997a; Hveem, 2000; and Mittelman, 2000: 4). While it is true that no region in the present time can be wholly insulated from outside pressures (Hurrell, 1995: 46), the substantial differences in the agenda, scope and institutional form of the different projects of economic regionalism in the world today implicate regional and domestic level dynamics as well.[10] Explanations that focus solely on a single level of analysis are, therefore, not likely to advance our understanding of contemporary economic regionalism (Hurrell, 1995: 72). Nevertheless, it is logical to consider globalisation, to be defined in Chapter 1, to be a significant driving force of regionalism, and consequently for the international level to be a key level of analysis in studies of contemporary economic regionalism, including AFTA.

Russia, Vietnam, and Peru. The last three countries are APEC's newest members, having joined the grouping in 1998, after which APEC members voted to impose a moratorium on new members for a period of time.

[9] For instance, former Nigerian head of state, Olusegun Obasanjo called on African countries to emulate the Europeans and form their own regional grouping to pool capacities and take charge of African economic development (Aluko, 1991: 37).

[10] Mansfield and Milner (1997: 15) note the substantial diversity of contemporary regional arrangements.

Outline of the chapter

Before attempting to answer the research questions outlined above, it is useful to review the existing literature on AFTA and ask how scholars of AFTA have explained what was then regarded as an unexpected turn to regional economic cooperation in 1991. What were the main reasons advanced for this move and what theoretical approaches did these answers draw on? More importantly, how well are these studies of AFTA able to provide answers to the questions raised above? This is the focus of Section 2 of this introductory chapter. Based on this discussion, Section 3 advances some thoughts on an appropriate analytical framework to govern the dissertation's study of AFTA and defines the scope of the study. Section 4 discusses in some detail the research methodology. The concluding section outlines the structure of the dissertation, briefly summarising the main arguments and findings of the dissertation as they appear in the various chapters. It also highlights the original contribution that the dissertation claims to make to the literature.

1.1 Definitions and Clarifications

Before proceeding to Section 2, it is important to first define key terms from the literature on regionalism that are used in this dissertation. Scholars of international politics employ terms like 'regionalism' and 'regional cooperation' to describe similar activities and processes. Andrew Wyatt-Walter defines regionalism as "the conscious policy of states to coordinate activities and arrangements in a greater region" (Wyatt-Walter, 1995: 77), a definition that is adopted in this dissertation. *Economic* regionalism then refers more specifically to the regional coordination of *economic* activities, instruments, and arrangements. Robert Keohane defines cooperation as occurring when the actions of separate individuals or governments previously not in harmony are "brought into conformity with one another through a process of negotiation, which is often referred to as policy coordination" (Keohane, 1984: 51). In this dissertation, the term 'economic regionalism' is also used interchangeably with the term 'regional economic cooperation', since both concepts stress the process of economic policy coordination among governments within a particular region.

Economists, on the other hand, adopt the term 'regional (or preferential) trading arrangement' to refer to what students of international politics term economic regionalism or regional economic cooperation.[11] These are essentially similar concepts, as they focus on policy coordination to reduce barriers to economic interactions between countries, although regional *trading* arrangements, by definition, focus specifically on policy coordination to reduce barriers to trade or exchange relations. Nevertheless, regional trading arrangements may be considered to be a subset of the analytically broader concepts of economic regionalism or regional economic cooperation, since they are all the outcome of the political choices of national governments to coordinate economic policy regionally.

Regionalism and regionalisation

Many scholars make a conceptual distinction between regionalism and regionalisation. The former is interpreted as a policy-driven process while the latter is viewed as the result of market-led processes of social and economic interaction within a region (Wyatt-Walter, 1995: 77; Hurrell, 1995: 39). While state policies may eventually result in regionalisation, the most important driving forces behind the growth of economic interactions within a region come from markets, namely from the decisions and actions of private traders and investors. Although the two terms 'regionalism' and 'regionalisation' may be related analytically as well as in practice, it is best to conceptually distinguish between them, simply because different sets of explanations may be required to explain 'regionalism' and

[11] See, for instance, Mansfield and Milner (1999: 592).

'regionalisation'. Notwithstanding their conceptual and practical interrelationship, this dissertation is primarily concerned with explaining economic regionalism, or the political decision of governments to cooperate, rather than regionalisation. Nevertheless, the empirical discussion reveals how ASEAN economic regionalism may well be altering regionalisation dynamics in Southeast Asia and in the wider East Asian region.

2. Limitations of Current Studies of AFTA

Although there is a substantial body of work on AFTA, much of this is either atheoretical or largely economistic, the latter focusing essentially on the welfare implications of AFTA on its member economies. When trying to explain why the ASEAN member governments decided to establish AFTA, scholars, especially economists, have merely cited a range of political and economic reasons that possibly motivated the ASEAN leaders to consider forming a free trade area in 1991 (Imada, 1993; Ariff, 1994; Low, 1996; Chia, 1998). In their view, AFTA is the outcome of a complex interplay or conjunction of the following political/strategic and economic factors at the beginning of the 1990s.

AFTA is explained as the economic instrument that ASEAN members adopted to give ASEAN new political purpose after the end of US-Soviet confrontation and the resolution of the Cambodian crisis, and to provide the foundation of Southeast Asian regionalism in the 1990s (Buszynski, 1997: 557). ASEAN members, it is argued, were committed through the AFTA project to maintaining ASEAN's identity as a purposeful and viable regional organisation in a post-Cold War era (Soesastro, 1991: 2; Ariff, 1994: 31-32; Ravenhill, 1995: 853). This was all the more urgent amidst fears that APEC would marginalise ASEAN in regional affairs as well as drive a wedge between ASEAN members by meeting their different economic needs (Buszynski, 1997: 566-68; Bowles and MacLean, 1996: 340).

The very real possibility in 1991 that the Uruguay Round negotiations of the GATT would fail, coupled with the turn towards regionalism in North America and Europe was believed to have also stimulated the decision to form AFTA as an insurance should the world economy turn protectionist. Being highly trade-dependent economies (Ariff, 1998: 2-4), the ASEAN countries were fearful that their major markets in the industrial world would become increasingly closed to their exports. The single regional market was also regarded as a means to attract foreign direct investment (FDI) to the ASEAN countries that, at the beginning of the 1990s, appeared in danger of being diverted to other newly emerging markets (Ravenhill, 1995: 854; Bowles and MacLean, 1996: 336; Low, 1996: 198; Chia, 1998: 218).

Clearly, a range of factors, both strategic and economic, probably influenced the decision by the ASEAN leaders to form AFTA. This dissertation acknowledges that public policies, including foreign economic policies, are usually formulated with multiple objectives and a range of anticipated eventualities in mind. Nevertheless, some sense of the relative causal importance of these diverse factors would have been useful in anticipating the future evolution of AFTA. As such, some of the pessimistic predictions in the literature about AFTA are widely off the mark.

Unanswered questions

While these factors help to account for the 1991 decision to form AFTA, they are less able to explain why the project was sustained and indeed advanced after 1991, particularly as many of the initial reasons for AFTA's formation were no longer salient. For instance, the Uruguay Round negotiations were successfully concluded in 1993. By 1995, APEC had become far less threatening than in 1993 through the grouping's decision to adhere to the principles of voluntarism and non-binding commitments.[12] Moreover, it was clear by this time that Europe and North America were not turning away from free trade into protectionism. Global foreign direct investment flows had, by 1995, resumed their growth trend after the decline experienced during the early 1990s (Dicken and Yeung, 1999: 111).[13]

Why then did the ASEAN governments take the political decision to sustain the project despite the emergence of domestic opposition to it, and in fact, to subsequently accelerate the project and expand its scope if the original forces behind the initial decision to establish AFTA had become far less salient? It is insufficient to only focus on explaining the initial decision in 1991 to establish AFTA. We need to ask why and how the project was sustained, what accounts for its substantial expansion through the decade, and indeed how to explain some of the notable departures from the project's original commitments. Better theorisation is clearly needed to determine the primary forces underlying these developments.

Although the literature on AFTA is noticeably atheoretical, the writings may be grouped into three broad categories of implicit theoretical approaches. A large portion of the early literature on AFTA adopted a neoclassical framework of analysis that essentially sought to assess the project's net welfare benefits. These writings were less able to provide plausible explanations for why AFTA was established, both on theoretical and empirical grounds. Economic studies of regionalism, in general, pay little attention to the political choices and conditions shaping regionalism (Mansfield and Milner, 1999: 589). Later works that moved away from a pure neoclassical model of trade but that continued to stress the key

[12] Ravenhill (2000) discusses APEC's mode of operation.

role of economic incentives have fared better, particular those focusing on investment rather than solely on trade flows.[14] Some works adopt an implicit realist interpretation of AFTA, seeing AFTA as a means by which the ASEAN member governments sought to attain strategic goals. A third set of writings on AFTA adopts a political economy approach that integrates economic and political dynamics in attempting to account for AFTA.

2.1 Neoclassical Approaches

Neoclassical analyses of regionalism are based on customs union theory and calculations of the net welfare gains arising from the trade creation and trade diversion associated with regional trade liberalisation.[15] Early studies of AFTA based on the neoclassical perspective thus relied on calculations of economic gains to suggest why regionalism might constitute an economically rational policy choice. These calculations revealed instead that unilateral or globally negotiated trade liberalisation would yield far superior economic gains compared to AFTA.[16] This confirmed the key theoretical insight from customs union theory, namely that only a global union would be welfare superior since it would avoid all trade diversion. ASEAN's core trading links were with the non-ASEAN world, and any diversion of trade patterns towards the region as a result of AFTA was expected to be detrimental to the growth prospects of the ASEAN economies (Ariff, 1998: 8-9).

For this reason, the wider APEC forum established in 1989 was felt to be a far more viable project of regional economic cooperation compared to AFTA owing to the greater

[13] Also see Table 3.1 in Chapter 3 of this dissertation.
[14] See, among others, Bowles and MacLean (1996); Athukorala and Menon (1997); and Petri (1997).
[15] The seminal contribution to customs union theory is Jacob Viner (1950).

economic benefits APEC offered to the essentially export-oriented ASEAN member countries (Mattli, 1999: 171). Net welfare gains were calculated to be higher in APEC than in AFTA (Low, 1996: 200-205). This is unsurprising, as among APEC's members were the two major markets for exports from the ASEAN countries, namely the United States and Japan.

Although some dynamic gains from exploiting scale economies in AFTA were expected to boost the project's overall welfare gains, the scale economies argument by itself cannot be sustained on theoretical grounds. There is no logical necessity for a regional arrangement to exist before scale economies can be exploited, provided global markets in general are not closed (Panagariya, 1999: 121). When local production is expanded in order to reduce costs, whatever is not consumed locally may quite easily be exported. Thus, Oman (1994: 23) notes that the scale economies argument does not provide a rational justification for ASEAN regionalism since the member countries have extensive trading links with other countries. The successful conclusion of the GATT Uruguay Round negotiations in 1993 reinforced Oman's point, however uncertain the prospects for an open, multilateral trading system had seemed just three years earlier.

Limitations of the neoclassical framework

A fundamental shortcoming of the neoclassical model is its central emphasis on trade. Analyses based on this approach attempt to account for the formation of regional trading arrangements by focusing on the welfare gains generated as a result of trade specialisation within regional groupings. By doing so, the neoclassical approach assumes an excessive economic rationality on the part of policymakers centred on their knowledge of the

[16] Low (1996) provides a comprehensive review of the various empirical studies that yield this

expected welfare gains arising from trade-induced specialisation that regionalism will yield in order to explain current political decisions to cooperate. Moreover, the model's utility as an explanatory tool in the contemporary world economy is limited since other forms of economic interactions, notably investment flows, which are equally, if not more, salient are neglected.

Part of the reason for traditional trade theory's limited utility in explaining contemporary economic regionalism lies with its underlying assumption of perfect markets.[17] Because firms are price takers in the neoclassical world, they and the activities that hinge on firm behaviour like production, foreign investment and technological development tend to be invisible in analysis (Helpman and Krugman, 1985: 39-40; McCulloch, 1993: 39). The neoclassical perspective thus says little about the role of the very large firms that undertake much of the world's production, trade, investment and technological innovation (McCulloch, 1993: 39).[18] This makes it difficult to use neoclassical theory to analyse the globalisation-regionalism relationship, since one of the key features of globalisation is the growing dominance of large firms in the world economy.

The traditional emphasis in neoclassical analysis on the notion of segmented national economies linked to each other by trade flows is similarly limiting. In these models, an economy or country is regarded as a basket of resources – capital, labour, land, raw materials – which collectively constitute its comparative advantage, and "which are assumed to stay within its borders" (Petri, 1997: 191). In the contemporary world

conclusion. See also Australia (1994).

[17] These are characterised by constant returns to scale; a large number of small firms that are price takers in the market; unchanging demand and tastes; costless access to technology; and perfect information.

economy, where capital flows often surpass the flow of goods, economic growth depends less on what factors a country is originally endowed with than on what factors it is able to attract through the world economy.[19] This suggests there may be a role for an activist government in creating the conditions that can draw in FDI, a conclusion that is at odds with the normative emphasis in neoclassical theory on minimal state regulation of the market, unless it is to correct market imperfections.

Neoclassical theory regards the economic and political domains as two separate spheres of activity with their own distinct dynamics. The market is viewed as an impersonal device that allocates resources based on the price mechanism, and by extension is seen as apolitical, while the state[20] is regarded as a collective set of political actors and institutions likely to interfere with the self-regulating market. This view of a state or political authority essentially distinct from the self-regulating market or economy is not consistent with reality (Polanyi, 1944: 71). In Southeast Asia, moreover, the market has long been employed by political authority to achieve particular social and political outcomes (Beeson and Jayasuriya, 1998: 316).

The state-market relationship is better conceptualised in the scholarly field of International Political Economy (IPE), which emphasises the reciprocal connection between the control

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[18] While the analysis of trade and investment policies in small or developing countries has often revolved around concerns involving imperfect markets, these phenomena are essentially treated as departures from mainstream or neoclassical economic theory.

[19] It also depends on what factors it can create through policy, such as skilled resources and technology development capabilities, giving rise to the notion of dynamic comparative advantage.

[20] The state is best defined as a political community formed by a territorially defined population and subject to one government (Hague *et al*, 1998: 6). Internally, it comprises a distinct set of political institutions that govern the life of the internal political community in line with the latter's common interest (McLean, 1996: 472). These institutions include the political executive or government; the administration including the bureaucracy, central bank and public enterprises; the legislature; the judiciary; the various organs of coercion (police, military); and sub-central or local governments (Miliband, 1973: 46-51).

of economic resources in the market economy and the exercise of political power (Underhill, 2000: 4). Markets are not merely mechanisms that enable the efficient allocation of economic resources they also allow the allocation and consolidation of political power. This suggests that political leaders and policymakers will evaluate any development that affects the market and economy not merely in terms of its economic effects but also for its political implications. In such a context, regionalism outcomes are likely to be driven by the interaction of both economic and political imperatives. Neoclassical economic theory does not reject the close relationship between economics and politics, in fact partly attributing departures from the economic rationality suggested by neoclassical models to political factors, the other being misinformation on the part of policymakers. The problem with this approach is that it leaves much real-world developments unanswered because it abstracts from the political dimension of the market.

2.2 AFTA as a Strategic Project – The Strategic Realist Interpretation[21]

Many scholars of ASEAN have also advanced essentially realist-based explanations that focus on the strategic dynamics associated with ASEAN to account for the AFTA project. The strategic realist approach, because of its emphasis on power, security and survival as central variables, points to the formation of regional groupings as strategic responses to power political competition, with no difference between political/strategic regionalism and economic regionalism (Hurrell, 1995: 49). Stephenson's argument that AFTA is pursued "more for foreign policy and strategic reasons than for economic reasons" reflects this line of thinking (quoted in Pangestu, 1995: 136).

[21] The interpretation is termed 'strategic' realist to distinguish it from the economic realist perspective on IPE.

As already noted, AFTA is also viewed as an economic instrument adopted to revitalise ASEAN and give it renewed strategic significance in a post-Cold War world. In this realist interpretation of events, waning superpower confrontation between the United States and the Soviet Union from the late 1980s reduced not only the strategic significance of ASEAN to external powers, particularly the US, it also weakened the utility of the association to its own members. The strategic interpretation of AFTA is, however, limited by the realist preoccupation with the political/strategic over the economic, and the tendency to regard the state as a black box in analysis. Domestic dynamics are ignored, while the actions of state actors are regarded as driven purely by systemic forces.

Discarding the unitary state assumption: AFTA has real domestic economic effects

Once the black box of the state is opened up and the domestic level admitted into the analysis, it becomes difficult to see how AFTA could have been sustained and in fact, expanded in terms of its agenda purely as a political/strategic project. The economic policy shifts required to implement AFTA would inevitably have introduced material changes to the respective economies of the core ASEAN countries. These policy changes had the potential to alter domestic distributional arrangements, especially in the new issue areas like agriculture, services and investment, all of which had been used by one or more of the core ASEAN governments to achieve domestic social and political objectives. The tendency to treat the state as a black box in much realist analyses obscures these crucial domestic dynamics that are likely to shape political responses.

It is, therefore, not unreasonable to argue that political leaders would have been unlikely to accept the material changes that a regionalist policy like AFTA would have introduced into their national economies unless these changes were desired in themselves. Otherwise, it would have been difficult for the ASEAN countries to sustain AFTA, important though the political/strategic goal of ensuring ASEAN's future may have been. The core ASEAN countries have always placed great emphasis on domestic economic needs, and continued to do so well into the 1990s (Kurus, 1994: 38).[22] Political/strategic imperatives arising from the end of superpower confrontation between the United States and the Soviet Union towards the end of the 1980s may have been partly responsible for the initial decision by policymakers from the core ASEAN countries to establish AFTA. It is, however also clear that we need to understand more precisely the role of AFTA in the domestic political economy calculations of the ASEAN member economies if we are to explain the evolution of the project through the decade.

2.3 Political Economy Approaches

A number of studies have attempted to explicitly or implicitly link economics and politics in their explanations of AFTA, using insights from a range of theoretical traditions in International Relations (IR) and International Economics.

Trade-centred explanations

Drawing on transaction cost economics (or the new institutional economics) and neoliberal institutionalism from IR in his study of comparative regionalism, Walter Mattli develops a model of demand and supply conditions for successful economic integration, which he uses to predict that AFTA is likely to fail (Mattli, 1999: 169).[23] He argues that regionalism is more likely to succeed if there is strong market-led pressure for cooperation arising from the significant "potential for economic gains from market exchange within a region"

[22] The notion of 'national resilience', a core doctrine in ASEAN, reflects the centrality of domestic politico-economic priorities. It emphasises the crucial role of domestic economic development as a means to a materially satisfied citizenry who would then be less vulnerable to internal and external subversion. See Leifer (1989: 3-4).

(Mattli, 1999: 42). AFTA does not meet this critical demand-side pre-condition for successful economic cooperation because the volume of trade in the ASEAN/AFTA region remains low.[24] Thus, there is little incentive for business leaders to apply pressure on governments to promote regional cooperation to reduce the costs of cross-border exchange relations.

Although Mattli is correct to emphasise the importance of locating explanations for economic regionalism in the context of the economic gains that accrue from regional cooperation, his focus on exchange or trade relations as a source of those gains while neglecting the investment dimension is limiting. Moreover, this approach suffers from a key shortcoming of neoliberal institutionalism, namely its argument that growing economic interdependence between countries is a necessary precondition for formal cooperation due to the convergent preferences that interdependence creates.[25] Thus, the low level of intra-ASEAN trade is argued to preclude successful regional cooperation in ASEAN. This is, unfortunately, an overly static approach to regionalism that does not take into account the possibility that convergent preferences in favour of regionalism may well arise from other sources, the international or systemic level for instance, despite low levels of regional economic interdependence.

FDI-centred explanations

A number of scholars interpret AFTA in terms of its role in attracting FDI. The growing importance of FDI-sponsored growth in the different ASEAN countries made AFTA a

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[23] Yarborough and Yarborough (1992) provide a comprehensive discussion of the new institutional economics, while the main arguments of neoliberal institutionalism are detailed in Keohane (1984, 1989).

perceived necessity when changes in the international political economy substantially increased worldwide competition for FDI (Ravenhill, 1995: 854; Bowles and MacLean, 1996: 333-36; Hay, 1996: 267-68). Economists who had previously regarded AFTA as an inferior exercise in welfare terms and inconsistent with global free trade have now come to accept this interpretation.[26] AFTA, in these accounts, is regarded as an instrument through which investment diversion from the ASEAN region would be avoided rather than a means to trade creation as in neoclassical approaches (Petri, 1997). It is, thus, the political economy of foreign direct investment that is salient to understanding the development of AFTA (Higgott, 1997b: 261).

The FDI-centred explanation is, however, incomplete. Most importantly, it does not explain why foreign investors, ostensibly the main actors AFTA is purported to attract, are treated less favourably in the AFTA investment liberalisation programme than ASEAN investors. The latter are scheduled to receive national treatment and be allowed market access by 2003 while foreign investors are to receive these benefits only by 2020. The wisdom of such a policy move has, in fact, been questioned in view of AFTA's perceived role as a means to attract foreign capital (Menon, 1998: 18; Tham, 1998: 32-33). While AFTA may be a response to the growing international competition for foreign investment, it is also clear that we need to consider other dynamics centred on the distinction between domestic and foreign capital if we are to account for this inconsistency in the AFTA project. It is likely that the answer lies in the domestic political economy of the member countries, specifically in the political significance of domestic capital.

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[24] Intra-ASEAN trade in 1985 was 18.6 per cent of the total trade of the six core ASEAN countries, falling marginally to 17.4 per cent in 1990 although it rose to about 20 per cent in 1995. See Ariff (1993: 2) and Tongzon (1998: 50).
[25] See Keohane (1989: 2).
[26] Compare, for instance, Ariff (1994) and Ariff (1998).

Emphasising domestic politics

Unfortunately, many political economy studies that attempt to integrate domestic political economy dynamics when explaining the decision to form AFTA do so only in a limited way. None of the studies reviewed point to a relationship between the political significance of domestic capital and the form that regionalism takes. Bowles and MacLean (1996: 337-39), for instance, emphasise the growing influence of reform-minded business interests and the prior adoption of neoliberal economic reforms in removing any serious political opposition to AFTA. Stubbs (2000) similarly accords primary explanatory importance to the shift in the domestic balance of power from economic nationalists in government and the bureaucracy who had adopted essentially inward-looking economic policies to the liberal reformers/technocrats who favoured economic liberalisation.

While these internal political economy developments may explain why it was politically feasible to establish or sustain AFTA, they do not account for the political decision to establish AFTA in the first instance. These domestic political changes are just as likely to have led the ASEAN governments to engage in unilateral trade liberalisation or to focus exclusively on multilateral or even APEC trade liberalisation. Arguments about the domestic political ascendancy of reformers favouring a more liberal economic regime do not also explain why member countries would agree to treat foreign investors less favourably than ASEAN investors when offering market access and national treatment. There is also failure to recognise that the shift towards economic liberal policies in the ASEAN countries was not unequivocal. Both sets of policies co-existed during the 1990s in the core ASEAN countries, though to different extents. These complexities, which have substantial implications for the conduct of regional economic cooperation, are ignored in these analyses.

Accounting for implementation: the role of regional-level political processes

Scholars like Stubbs (2000) and Mattli (1999) fill a gap in the literature on regional economic cooperation by emphasising the importance of implementation processes that are as necessary to secure successful international cooperation as are convergent preferences. The analysis of regionalism all too often focuses on the initial decision to establish a particular regionalist project and fails to ask how the commitments made are implemented, or if they are not, why, and how non-compliance is dealt with at the regional level by the grouping's members.

Stubbs (2000) suggests that the regional political culture – the 'ASEAN Way' – that emphasises flexibility, informality over formal rules, consultative processes and consensus-building played a significant role in helping to move AFTA forward.[27] This argument is, however, inadequate. It neglects the growing significance of rule-based institutions in AFTA, as the discussion in Chapter 6 reveals, which are clearly departures from what Stubbs stresses to be ASEAN's normative preference for informality. Stubbs is, nevertheless, correct to emphasise the role of consultations, compromises and flexibility in helping to advance AFTA, although he does not provide conclusive evidence that this was due to adherence by member governments to ASEAN norms, rather than being driven by interests. Many international agreements are advanced through similar processes (Jonsson and Tallberg, 1998), a point that weakens the cultural explanation in the AFTA case.

[27] The 'ASEAN Way' is a regional code of conduct that is characterised by informality, aversion to formal institutions, flexibility, pragmatism, expedience, the practice of consensus, a high degree of discreteness, and non-confrontational bargaining styles developed through a process of elite socialisation over a period of time (Acharya, 1997: 329).

Mattli (1999: 12) points to the role played by a regional leader and centralised institutions in ensuring that implementation proceeds in accordance with treaty commitments.[28] Hegemonic power and institutions are stressed in this framework. A regional leader is emphasised as crucial in easing distributional problems by acting as regional 'paymaster' and in providing a normative focal point for the regional standards and policies that are necessary for deeper integration beyond tariff liberalisation (Mattli, 1999: 170). The absence of a regional leader in ASEAN, according to Mattli, does not augur well for AFTA on both these counts (Mattli, 1999: 169).

Mattli does not, however, consider the alternate possibility that distributional functions may be performed through other mechanisms, institutions for instance.[29] He also fails to recognise that a regional leader is probably unnecessary as a normative focal point since the ASEAN countries have opted to harmonise regional policies, standards and regulations to international norms where these exist, a logical move given their predominantly global economic focus. The emergence of rule-based though decentralised institutions in AFTA, discussed in Chapter 6, is also missed by Mattli, who adopts a Euro-centric view that only supranational or centralised institutions for monitoring and enforcement matter in implementation (Mattli, 1999: 54).[30]

Building on these political economy studies in the dissertation

Despite their limitations, these political economy studies are a substantial improvement over the more common atheoretical or economistic studies of AFTA. First, they emphasise

[28] This constitutes the supply-side of Mattli's model for successful economic integration. Leadership is the critical supply condition, with centralised institutions only a weak condition for successful integration (Mattli, 1999: 42-43).
[29] See, for instance, Martin and Simmons (1998: 739-42).

other forms of economic interactions and activities that are far more salient in the contemporary world economy such as investment flows and, therefore, are potentially able to enhance understanding of the turn to economic regionalism in the 1990s. Second, they explicitly seek to relate system-level structures and processes to the political decision to engage in regionalism made within the context of domestic political and social structures and processes. These interactions remain under-conceptualised in these studies, however. Third, they point attention to the need to consider how regionalist projects are sustained and advanced further once established.

3. An IPE Framework of Analysis

This dissertation builds upon the political economy studies reviewed above by exploring the relationship between the systemic, domestic and regional levels of analysis in greater depth as a way to answer the questions posed at the start of this chapter. The study is broadly located within an IPE framework of analysis, emphasising, therefore, the close interrelationship between states and markets, or between politics and economics, as well as the interaction between the domestic and international levels of analysis (Underhill, 2000: 6). The study also considers capital and production to be key issue areas rather than trade or exchange in line with the emphasis of the 'new' IPE.[31] Finally, the dissertation considers capital or business actors to be part of social wholes and rooted in domestic society rather than atomistic units, which consequently alters their relationship with state actors in ways that are likely to be significant for regionalism.[32] The neglect of one or all of these considerations is responsible for much of the shortcomings of the current literature on AFTA, as the discussion in the previous section revealed.

[30] A study on international institutions by Kahler (1995) reveals that successful implementation is not always achieved through centralised institutions.
[31] Murphy and Tooze (1991) discuss the theoretical foundations of the 'new' IPE.

3.1 The Globalisation-Regionalism Relationship: Theoretical Perspectives on IPE

More specifically, the dissertation locates the analysis of AFTA within the theoretical literature on the globalisation-regionalism relationship. Most scholars argue that contemporary economic regionalism is an outcome of globalisation, which any explanation of regionalism needs to take seriously. This literature is critically examined in Chapter 1, which reviews the two basic models of the globalisation-regionalism relationship. In short, globalisation is regarded in the dissertation as the relevant systemic-level condition that structures the operating environment for state actors and other social groups.

For the purposes of this chapter, the following discussion first summarises the shortcomings of the liberal political economy perspective on IPE, which underpins the model of open/neoliberal regionalism, the dominant model of the globalisation-regionalism relationship in the literature. The discussion then advances some preliminary ideas on an appropriate theoretical approach for the dissertation's analysis of ASEAN economic regionalism by examining structuralist and economic realist perspectives on IPE.

<u>The liberal political economy perspective</u>

The liberal political economy perspective on IPE shares many of the weaknesses of the neoclassical model, which provides its economic foundation. This approach emphasises the primacy of economics and of economic incentives in explaining outcomes, a separation of the state and market and the notion of capital or business actors as atomistic

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[32] See Murphy and Tooze (1991: 19-20).

units devoid of a social or historical context (Underhill, 2000: 14). Global market forces are, moreover, taken as a given and are regarded as benign, conferring benefits on all in a positive sum game. Governments accommodate to these beneficial market forces through neoliberal policies of deregulation, privatisation and liberalisation that also integrate their economies with global markets. The systemic level is, therefore, paramount in explanation.

The liberal perspective is rejected as a suitable theoretical approach for the dissertation for two reasons. One of the main shortcomings of this perspective is the absence of a realistic notion of politics. States, or rather their governments, acquiesce in and act in accordance with the logic of global market forces. The relationship between state and capital or business actors is simply one of governments freeing up the market for business activity. Politics is present to the extent that governments adopt protectionist policies due to their capture by uncompetitive business actors concerned with limiting the workings of the free market. In either case, governments are regarded as acting on behalf of business interests from whom they remain distant in social and political terms. This picture is at odds with the reality in Southeast Asian countries where state and business actors, particularly domestic business actors, are often close partners in elite governance political systems. Outcomes in international politics are inevitably influenced by this relationship, which consequently needs to be explicitly considered in the analysis of AFTA.

The structuralist perspective

The structuralist perspective on IPE derives from Marxist notions of political economy applied to the study of international politics. It conceptualises the relationship between state and capital in terms of the state acting as an instrument of the capitalist class, or of particular capitalist actors. International politics, thus, derives from the concern with the development of capital on a global scale (Hoogvelt, 1997: 8). Unlike the liberal approach, the structuralist perspective injects politics into structuralist analyses by regarding the outcome of international economic relations as a redistributive, zero-sum game. The perspective allows for the possibility of agency, albeit limited, in international politics – "voluntaristic and reformist actions" – as governments respond to and try and overcome global structural interdependencies and inequalities (Barry Jones, 1995: 34).

This perspective is rejected due to its strong element of economic determinism. Actions and outcomes in international politics are driven entirely by the logic of global capitalism, with the state acting as the instrument of capital. Although states are considered in analyses, they are not seen as political communities in their own right but merely as constituent units of a world capitalistic system. Domestic considerations and priorities stemming from domestic political constituencies are, therefore, irrelevant in structuralist analyses. Moreover, structuralist approaches focus exclusively on social groups derived from the capitalist mode of production – capital and labour, whether national or transnational – while ignoring other social groups, ethnic groups for instance that are significant in a number of ASEAN countries. In such instances, ethnicity often gives rise to vertical cleavages within capital and labour groups.

The economic realist perspective

The dissertation adopts the economic realist perspective on IPE as the most appropriate theoretical model for its study of ASEAN economic regionalism, compared to the liberal and structuralist perspectives. The economic realist perspective, clearly outlined by Barry Jones (1995: 30-32), comes from the realist tradition in IR from which it derives its three central features.

The realist school, of which E.H. Carr and Hans Morgenthau are the dominant contemporary intellectual pioneers, regards nation-states as central actors in international politics.[33] Second, the realist school infers international outcomes from the internal attributes of these nation-states (Burchill, 1996: 78). Morgenthau, for instance, specifies that interests, which drive international political action depend on the political and cultural context within which foreign policy is formulated (Morgenthau, 1948/85: 10-11). Finally, the realist school accepts the possibility that states have the potential to transform the international system. Morgenthau suggests that the contemporary world could be transformed "through the workmanlike manipulation of the perennial forces that have shaped the past as they will the future" (Morgenthau, 1948/85: 12). The realist school and by extension the economic realist perspective on IPE, therefore, part company with Waltzian neorealism on all three counts.[34] Neorealism exaggerates the importance of international structure in conditioning the actions of states whose internal attributes are consequently irrelevant to outcomes while also underestimating the potential of states to alter the international system (Burchill, 1996: 90).

Because nation-states are central in economic realist analysis, this approach is well suited to the study of the international politics of Southeast Asia where the nation-state matters a great deal (Alagappa, 1998: 680-85). The economic realist perspective moreover regards international economic relations in zero-sum terms, unlike the liberal economic perspective, therefore allowing for the possibility that governments would marshal power to interfere in global markets on behalf of their respective states in competition with other states (Hoogvelt, 1997: 7). There is potential for agency in this perspective as governments attempt to alter the structures and processes of the global economy through inter-state

[33] See Carr (1939/84) and Morgenthau (1948/85).

politics to realise the interests of the state (Barry Jones, 1995: 40).[35] The study rejects, however, the realist conception of these interests in terms of security and survival of the state in inter-state power political competition and instead derives these interests at the domestic level. Security for developing states in particular is often conceptualised in terms of the security of *domestic* political institutions and governing regimes (Ayoob, 1995: 8).[36]

Incorporating the domestic level with the economic realist perspective

In contrast to the liberal economic and structuralist perspectives, governments in the economic realist perspective are driven by the (security) interests of the state or political community, rather than from interests derived from the logic of (global) market forces or structurally derived from the logic of global capitalism. Unlike the structuralist perspective, the economic realist perspective regards states as independent units, notwithstanding their interdependent relations with other states and with non-state actors. Because nation-states are conceptualised as independent political communities in the economic realist perspective, there is no methodological problem with integrating an appropriate model of domestic politics with an economic realist analytical framework.

Moreover, in substantive terms, the realist tradition does accord analytical priority to the domestic level, unlike its neorealist counterpart. The primary insight of two classical thinkers who laid the foundations of realism – Machiavelli and Hobbes – is that domestic political structures and processes and international structures and processes are closely intertwined (Ayoob, 1998: 39-40; Williams, 1996: 215). As already noted above, Morgenthau similarly emphasises the importance of domestic context in shaping state

[34] The seminal neorealist text is Waltz (1979).
[35] This insight stems from this perspective's realist origins. Neorealism, on the contrary, leaves little room for systemic change induced by the units – states – themselves (Burchill, 1996: 87).

interests in international politics. Many contemporary scholars of international politics, Peter Gourevitch for instance, have long urged other scholars to examine domestic and international politics as a whole (Gourevitch, 1978; Kapstein, 1995).

The assumption made in the analysis is that governments respond in the first instance to domestic political constituencies on whom they rely for political support and for their legitimacy (Underhill, 2000: 18). In developing countries, legitimacy concerns are closely linked to concerns with the security and stability of prevailing political systems or regimes. Thus, while governments may be driven by concerns related to capital for instance, these are not derived from the logic of global capitalism, nor in relation to freeing up the market for business in some technical sense, but instead stem from domestically derived political priorities. Although the dissertation focuses on the relationship between *capital* and state/political elites in explaining particular outcomes in regionalism, this is not to suggest a Marxist or neo-Marxist conception of capital and of state-capital relations. As the discussion in the following section illustrates, the relationship between state and capital in the ASEAN countries is one conditioned by the imperatives of elite rule rather than the imperative of capitalist production.[37]

The international level – globalisation – nevertheless also structures the environment in which governments and other social groups operate, providing both constraints on some forms of action as well as opportunities for others. In short, the argument is that the domestic level is a key level of analysis, mediating between globalisation and regionalism, while the relationship between state and capital, or government and business, is more nuanced and less deterministic than in structuralist or even liberal perspectives. Moreover,

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[36] Regimes are defined in Chapter 1 (Section 3).

the focus on the domestic level allows the analysis to distinguish between foreign and domestic capital, a distinction that is missed in the liberal perspective but which Chapter 1 shows is crucial in the study of AFTA.

3.2 Choosing an appropriate model of domestic politics for the study of AFTA

The dissertation adopts the elite governance model of domestic politics as the most appropriate to characterise domestic politics in the core ASEAN countries.[38] An elite governance political system is most usefully viewed as a project whose principal aim is to maintain elite power, autonomy and exclusivity (McCargo, 1998). A survey of domestic politics and economic policymaking in the core ASEAN countries reveals that governance and policymaking during the 1990s continued to remain the preserve of elites. Elite coalitions usually comprised political, bureaucratic, military and business elites although the precise composition of these elite coalitions varied across the different countries. A growing middle class and the emergence of other social groups in these countries did not significantly alter the elite nature of governance and economic policymaking, even in Thailand and the Philippines where the middle class had become politically more active in increasingly democratic political systems.[39] Nevertheless, policymakers in the different countries did, to varying extents, recognise the interests and needs of these emerging social groups in making policy choices.

As the discussion in Chapter 1 reveals, elite governance political systems are characterised by tension that potentially exists between the growth and distribution imperatives inherent

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[37] Thus, the terms capital and business are used interchangeably in the dissertation.

[38] Other models of domestic politics include pluralist models, institutional theories, elite theories, and Marxist models (Milner, 1992: 494-95).

[39] See Robison (1996) for Indonesia; Rodan (1996) for Singapore; Pinches (1996) for the Philippines; Kahn (1996) for Malaysia; and Hewison (1996) for Thailand.

in these systems.[40] Both these imperatives are ultimately linked to political concerns centred on the legitimacy and security of governing regimes. Growth is defined as the expansion of economic wealth of a country, irrespective of its distribution among different groups, firms or individuals. Distribution is defined as the conscious allocation, usually by governments, of income, rents and other benefits to particular individuals, groups or firms who would otherwise not have received these gains through the workings of the free market. Distribution, in the context of this dissertation, does not, therefore, incorporate any normative connotation. The notion of distribution as used in the study is not to be seen as an egalitarian act, as something that is inherently 'progressive' involving the allocation of material and other benefits from rich to poor. Distribution may well involve the 'regressive' reallocation of wealth, from the poor to the rich, particularly to partners of ruling elites as the latter attempt to maintain elite cohesion and their power base.[41]

Based on these insights, the central hypothesis in the dissertation is that the type of regionalism that emerges out of the dynamics of globalisation is mediated by domestic political economy dynamics centred on the growth-distribution relationship, even for regionalism projects that seek engagement with globalisation. Chapter 1 discusses this argument in some detail, and derives from it three specific propositions relevant to AFTA.

Alternative approaches to characterising domestic politics in the ASEAN countries essentially rely on broad or higher-level generalisations of either the nature of the political regime – whether democratic, authoritarian, or semi-democratic – or the structural/institutional character of state forms – whether developmental or neo-

[40] Chapter 1 discusses the dynamics of elite governance systems in greater detail.
[41] See the discussion in Strange (1988/94: 212-13) on the idea of both progressive and regressive welfare systems.

patrimonial.[42] Both these alternatives were rejected on the grounds that they were overly stark representations of the domestic politics of the ASEAN countries that hid more than they revealed about particular political relationships and how policy choices are made. The bureaucratic polity model, in which governance and policymaking is dominated by bureaucrats, is also not an appropriate model of domestic politics for the ASEAN countries in the 1990s.[43] If bureaucrats did exert a dominant influence on policy, it was because they were permitted to do so by political leaders. Moreover, bureaucrats were often constrained by emerging commercial interests, which were often allied with political elites or which had political roles to play that were defined by political elites. Thus, it is the complex relationship between political, bureaucratic and business elites that is key in explanation.

The point is, neither the type of political regime nor the institutional/structural character of the state captures the core political and economic relationships among different groups of elite actors that predominate in the ASEAN countries. The elite governance model, on the other hand, focuses on precisely these underlying relationships. It is, thus, better able to account for economic policy choices in these countries, including policy choices regarding AFTA, irrespective of the political regime or the institutional/structural character of the state, although these are not entirely without influence.

3.3 The regional level matters

The regional level is also crucial in analysis, because it is at this level that political negotiations and bargaining take place to generate joint commitments to cooperate as well

[42] It is also important to note that apart from developmentalist Singapore, all the other core ASEAN countries display both patrimonial and developmental orientations. See Cotton (2000: 156 & fn.4).
[43] Laothamatas (1992) provides a useful discussion of the bureaucratic polity model.

as where implementation is accomplished. Because regionalism itself has the potential to affect domestic distribution, it is likely that sustaining cooperation would be an onerous task. Moreover, the different approaches among national governments to the growth-distribution relationship means that amidst the broad commitment to regional economic cooperation, divergent preferences on particular agenda items are more than likely. Thus, rather than being purely a technical process, implementation is likely to be as much a political process as is the initial stage of developing joint commitments through political negotiation. Chapter 6 draws on the considerable theoretical literature on 'compliance bargaining' for insights on how implementation issues are addressed by regional partners, particularly in non-hegemonic settings like ASEAN.

3.4 Scope of the research

The research covers the 1991 to 2000 period, and focuses on five of the six core ASEAN countries.[44] Indonesia, Malaysia, Singapore, Thailand and to a lesser extent, the Philippines were responsible for not only initiating the AFTA project they were also instrumental in determining the way the project evolved through the decade.[45] Moreover, major disputes or disagreements in AFTA over compliance and implementation were between two or more of these countries. The research also examines in greater detail three instances of disputes or tensions over trade liberalisation, namely in agriculture, automobiles and petrochemicals as a way of understanding more fully how international, domestic and region level variables interact in processes of regionalism.

[44] Although Brunei is a founding member of AFTA and is regarded as a core ASEAN country, its domestic political economy will not be examined in detail in the dissertation. Being an oil-rich state whose major economic activities are oil production, refining and export, its domestic political economy differs substantially from the other ASEAN countries, and relates very differently to the AFTA project compared to the other ASEAN countries as a result. Thus, Brunei is of marginal importance to the way the AFTA project has shaped up, at least up to the time of writing, although the Brunei government has always been a strong advocate of AFTA.

Although the research attempts to integrate domestic politics into the analysis, the dissertation takes neither a single country nor a comparative approach. Instead, it attempts to locate explanations for developments in AFTA in broad patterns of domestic politics in the core ASEAN countries using the framework of elite governance. As such, the analysis of domestic politics in the study must necessarily remain at a fairly general level, unlike other studies of regional cooperation in Southeast Asia that explore in great depth domestic level variables by focusing on a single country or by using the comparative approach.[46] Nevertheless, the dissertation's emphasis on the interaction between the international and domestic levels of analysis will hopefully provide new insights into the political processes shaping ASEAN economic regionalism that previous studies do not reveal, or at best have only hinted at.

4. Research Methods

This dissertation adopts the case study approach involving the detailed study of a sequence of social events and processes in order to identify particular relationships among historical events (Little, 1991: 29-31). The aim is to construct a causal narrative of AFTA – to account for the development of the AFTA project between 1991 and 2000. Construction of a causal story of AFTA requires first, detailed knowledge about the sequence of events within AFTA as well as within the global and domestic political economies of the late 1980s and 1990s, and second, credible hypotheses or propositions drawn from theory.

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[45] The analysis will concentrate on all five countries where relevant. Otherwise, the focus will be on the countries most pertinent to the issue(s) at hand.

[46] See Anwar (1994), Lim, K.T. (1998) and Hamilton-Hart (1999a).

The analysis employs documentary research as well as semi-structured elite interviews as sources of empirical material, both of which were crucial for the dissertation's study of AFTA. While secondary sources – official documents and newspaper archives – were used to build the narrative of AFTA between 1991 and 2000, primary data/information gleaned from elite interviews was key to providing the behind-the-scenes knowledge of negotiation, bargaining and decision-making processes in AFTA that secondary documents do not capture.[47] It was not possible to gain access to minutes of meetings related to internal decision-making and consultative processes in AFTA. Final official statements or agreements present only the outcomes of these processes. In such circumstances, elite interviews were used to provide crucial information with regard to the position of national governments on key issues in AFTA as well as to build a picture of how final decisions were reached through negotiations and bargaining. In addition, elite interviews were also useful in understanding the interviewee's subjective analysis of a particular episode or situation.[48]

4.1 Documentary Research

Documentary evidence came from secondary sources from the ASEAN Secretariat located in Jakarta, Indonesia and national governments. From the former, it was possible to obtain all formal agreements, declarations, programmes, protocols, amendments to agreements and communiqués relating to AFTA (and ASEAN where relevant), usually from the Secretariat's official website (www.asean.or.id). In addition, official press statements of all annual AFTA Council Meetings from 1992-2000, official press statements of all annual

[47] Primary sources refer to materials compiled first-hand by eye witnesses or participants of the event in question, and include diaries, memoirs, court records, minutes, memoranda, and letters. Interviews constitute one source of primary information. Secondary sources refer to published material based on primary sources, and include treaties, agreements, press releases, government white papers, official publications, and parliamentary debates. See Burgess (1984/90: 123-24).

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ASEAN Economic Ministers Meetings from 1987-2000, and official press statements of all leaders' meetings from 1992-2000 were also collected from this website. The ASEAN Secretariat also publishes a range of material on AFTA ranging from reports, information packs, and data sets that were useful in constructing the AFTA narrative as well as in piecing together evidence for the dissertation's main arguments. All material from the ASEAN Secretariat is in English, the official language of ASEAN.

Official documents from national governments relating to international, regional and domestic economic policies as well as national data/statistical sources provided additional empirical material while information on international economic trends were easily obtained from publications put out by international organisations. Only material that was written in English or in the Malay/Indonesian languages was accessed. While this allowed the analysis of official material from Indonesia, Malaysia, and Singapore (and the Philippines where relevant), only those official documents issued by the Thai government that had been translated from Thai into English were utilised.[49] Information on national policies in Thailand and Indonesia were also obtained from tertiary documents such as scholarly analyses where available. Finally, scholarly papers on economic regionalism and globalisation more generally, and of ASEAN and AFTA more specifically, were also consulted for empirical information and additional insights on AFTA as well as to locate the development of AFTA within broader developments in the international political economy.

[48] This is one of the key functions of elite interviews (Richards, 1996: 200).
[49] Official documents in Malaysia are prepared both in English and in the official Malay language (*Bahasa Malaysia*). Indonesian government documents are essentially in the Indonesian language (*Bahasa Indonesia*), which is very closely related to the Malay language, although translations are

Newspaper sources stretching from 1991 were a very valuable resource when constructing the AFTA narrative. Both national level and regional/international daily newspapers and weekly news journals were consulted. These were essentially in English, although newspapers and news journals in the Indonesian language were also consulted. Newspaper sources, however, are not always accurate. Where possible, newspaper coverage of items on AFTA was cross-referenced across a range of newspapers from different country and international sources to minimise the possibility that national biases or the biases and interpretations of the journalist colour the way a particular story is presented.

4.2 Elite interviews

Elite interviews were conducted in a semi-structured way between July and September 2000. Instead of a rigid questionnaire, an aide memoir was used that could be referred to during the interview. A total of 26 separate interviews were conducted with 29 individuals in this manner, for about one hour per interview (although a few interviews lasted about 40 minutes) in four countries – Indonesia, Malaysia, Singapore and Thailand. It was not possible to conduct field interviews in the Philippines due to time and funding constraints. This was not a serious limitation, however, since the Philippines was not at the forefront of major developments in AFTA. Moreover, Philippine responses to AFTA agenda items were extensively reported in regional newspapers. One interview was conducted through electronic mail using a set of questions to which the interviewee, from Malaysia, responded in writing. Further clarification from interviewees, if needed, was obtained either through electronic mail or telephone.

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sometimes available. Singapore government documents are in English. Documents issued by the Thai government are always in the Thai language, while translations are usually rare.

Elites are essentially individuals or groups who hold, or have held, a privileged position in society and thus, likely to assert a stronger influence on political outcomes than members of the general public (Richards, 1996: 199). Thus, logical interviewees would be ministers, senior officials in government such as permanent secretaries and their deputies, as well as heads of government departments, agencies and research institutes or think tanks. For this dissertation, interviews were also conducted with middle level officials and scholars. The former generally has detailed operational knowledge of government and inter-governmental workings and processes while the latter is able to provide valuable local knowledge, particularly about political dynamics that helps in the interpretation of events.[50] Thus, interviewees for this study of AFTA included two ministerial level subjects, namely the Secretary General and Deputy Secretary General of ASEAN, senior and middle level officials from the Secretariat and from national governments in the four ASEAN countries, as well as scholars. None of the persons contacted for interviews turned down the interviewer's request, with the exception of one political scientist in Thailand who had for some years moved into a senior administrative position in the university and felt he was unable to shed new light on political dynamics in Thailand.

Interviews can be taped or notes made throughout the interview or a combination of both. For this dissertation, following Richards (1996: 202), interviews were not taped as it was believed that taping would result in interviewees being less forthcoming in the information they provide if they knew their remarks were being recorded. Interviews have generally been "on the record"; hence the dissertation is able to attribute information and insights to

[50] Civil servants are thought by some scholars to be the best interviewees, as they tend to be dispassionate, are good at observing action, and often are veritable storehouses of valuable information. See Richards (1996: 201).

individuals where relevant. Only one interviewee, from Malaysia, requested anonymity, while other interviewees indicated which information should not be attributable.

The reliability of information is always a problem in interviews, where interviewees tend to present their personal, subjective view of events. In general, information and interpretation of events gleaned from one interview was cross-referenced with material obtained from other interviews on the same event. In particular, the cross-referencing of interviews across countries helped to reveal the personal or national biases of interviewees, although these in themselves were useful or even central to the interviewer and the study as they indicated national differences in the way events were perceived.

No interviews were conducted with business representatives. This may appear, at first glance, to be a shortcoming given that the dissertation deals with globalisation and capital/business. Informal discussions with scholars who study business behaviour in the ASEAN countries as well as a perusal of newspaper interviews of business leaders reveal that it is very difficult to make accurate generalisations about the position of business actors in complex industrial structures. Industry-level generalisations from a limited set of interviews of business actors are thus not possible, and likely to lead to erroneous conclusions, particularly when an industrial sector comprises a range of firms that differ in the positions they advocate on trade liberalisation more generally and AFTA more specifically. Industry or business associations tend to include a mix of various types of firms, making a unified policy position difficult to ascertain, a problem commonly experienced by national governments engaging in consultations with peak business associations.[51]

This dissertation, nevertheless, utilises official documents and public statements from relevant business associations as well as public statements and newspaper interviews of relevant businesspersons as a way of understanding the different reactions of individual corporate actors towards AFTA. It also uses the results of surveys of business executives on the subject of AFTA conducted by a range of organisations – the Japanese Export-Import Bank, the Nomura Research Institute, the Economist Intelligence Unit as well as the regional news journal, the *Far Eastern Economic Review*. The results of these surveys were reported in analyses of regional business trends in various newspapers and news journals.

5. Conclusion: The Dissertation in Outline

Following this introductory chapter, Chapter 1 reviews the theoretical literature on the globalisation-regionalism relationship, beginning with a conceptual clarification of globalisation as a way to enable better theorisation of its relationship with regionalism. While the theoretical literature identifies two models of the globalisation-regionalism relationship, one centred on acquiescence to global market forces (open/neoliberal regionalism) and the second emphasising resistance to globalisation, Chapter 1 advances a third theoretical model – what I call developmental regionalism – by using a combined economic realist-domestic politics theoretical framework. The main emphasis in developmental regionalism is the nurturing of domestic capital and the building up of domestic industrial and technological capabilities. Explicit attention to domestic politics,

[51] Newspaper reports in the different countries reveal that different firms within the same industry

specifically to the politically important role of domestic capital led to this theoretical insight. The economic realist approach also allowed a subtle distinction to be made within the dominant open regionalist model in the literature between a neoliberal variant and an FDI model. While both variants emphasise engagement with global market forces, neoliberal regionalism is driven by concern with economic efficiency while the FDI variant is driven primarily by the need to attract FDI rather than efficiency considerations, and thus, may display only limited neoliberal characteristics.

These theoretical insights enabled a more nuanced reading of the empirical trends associated with AFTA, which are detailed in Chapter 2. While the current literature explains AFTA as a project of open regionalism focused on the need to attract FDI to the region, the dissertation advances the argument that AFTA encompasses the features of *both* open and developmental regionalism due to the political significance of *both* foreign and domestic capital. Chapters 3 ands 4 respectively develop these arguments.

In the case of open regionalism, which was centred on the CEPT and displayed only limited neoliberal features, the ASEAN governments attempted through AFTA to offer foreign investors who were increasingly practising a regional division of labour an alternate regional space of production vis-à-vis China. China by itself offered investors a potentially competing regional investment site in the Asia-Pacific region, and was regarded by all the core ASEAN countries as ASEAN's primary competitor for FDI. Globalisation had, by the early 1990s, significantly increased competition for FDI, and provided an external trigger for regionalism in ASEAN, which was reinforced by the key role of foreign capital in the domestic political economy.

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did not always share similar policy positions and preferences on AFTA.

Notwithstanding the importance of foreign capital for economic growth, the political significance of domestic capital in a number of member economies prompted governments to also adopt the idea of developmental regionalism through the AIA component of AFTA. Concern about the future of domestic capital, as with the anxiety about FDI, was similarly triggered by developments at the systemic level. In this instance, globalisation manifested itself through changes, or anticipated changes, in its institutional underpinnings and as a hegemonic cognitive structure. ASEAN policymakers and leaders were confronted with the possibility of new multilateral rules that would privilege foreign firms and disadvantage fledgling domestic firms, while they also increasingly perceived an unrelenting globalisation involving intense international competition with global/foreign corporations. These pressures, while to some extent reinforcing open regionalism in AFTA, also raised substantial concerns in some countries with regard to the future of domestic capital.

Developmental regionalism was the outcome of these concerns, and it accounts for ASEAN's puzzling offer of earlier market access and national treatment privileges to domestic/ASEAN investors ahead of foreign investors in the AIA, which governments hoped would stimulate the growth of internationally viable domestic firms. Strategic trade logic, rather than neoclassical logic, provides the economic foundation for the notion of developmental regionalism. Although both forms of regionalism were driven by the concern with growth, the growth imperative in developmental regionalism was infused by political priorities involving the distribution of economic benefits to domestic capital. In short, the type of regionalism that emerged in response to globalisation was mediated by domestic political economy dynamics centred on the growth-distribution tension inherent in elite governance political systems common in the ASEAN setting.

Despite their keen interest in pursuing both open and developmental regionalism through AFTA, the ASEAN governments were, nevertheless, prepared to renege on their original commitments in particular instances in order to protect the interests of politically important social groups and domestic firms that had close ties to the political elite. Chapter 5 elaborates on this argument, namely that distribution concerns were sometimes so overwhelming that they overrode the concern with growth and led to setbacks in AFTA. Although this invariably led to disputes within ASEAN, member governments also engaged in compliance bargaining processes as Chapter 6 reveals to find ways to balance these particular domestic political priorities centred on distribution while also ensuring that the AFTA project continued to advance. One outcome of compliance bargaining, highlighted in Chapter 6, is the strengthening of institutions in ASEAN/AFTA through rule building. The concluding chapter sums up the results of the dissertation, provides an overview of the arguments put forward as well as assesses the conceptual and methodological approach adopted in the analysis. New issues and questions raised by the analysis are highlighted, while promising lines of further inquiry are identified.

The discussion thus far points to at least three original contributions the dissertation can claim to make to the scholarly literature. It makes a substantial empirical contribution to the literature on ASEAN and on economic regionalism by providing a detailed narrative discussion of AFTA from 1991 when the project was initiated to 2000 using an extensive range of sources that were outlined in the previous section. This is detailed in Chapter 2 of the dissertation, which describes not only the commitments made in AFTA in all three component programmes – CEPT, AFAS and the AIA – it also analyses implementation of these commitments. This had yet to be done for AFTA at the time of writing. Moreover, the dissertation contributes to the study of regionalism more generally by combining a theoretically informed and empirically detailed analysis of regional processes in a setting –

Southeast Asia – outside Europe and North America, a neglected area in the study of regionalism.[52]

Second, the empirical analysis of AFTA reinforces the dissertation's theoretical critique that domestic politics is key to mediating globalisation forces and shaping the form of regionalism that results, even in instances where regionalism seeks to engage with globalisation. Specifically, an explicit treatment of the domestic level allows the analysis to consider domestic capital as a key analytical variable, and consequently to advance the notion of 'developmental regionalism' as a third model of regionalism.

The dissertation also claims to make a contribution to the literature on ASEAN more generally. The analysis of implementation processes in Chapter 6 reveals that partial institution building involving strengthening rules and procedures has taken place in AFTA. This insight challenges the prevailing wisdom that ASEAN member governments prefer only limited forms of institutionalisation involving processes of socialisation and consensus building, and employing minimal rules. Chapter 6 explains why ASEAN, always regarded as a hard case for rule-based institution building, should embark on this very process in AFTA. The findings of this chapter challenge the long-held view of an Asian hostility to western formalism[53] in the institutional design of regional cooperation.

[52] Breslin and Higgott (2000: 341) call for more studies of regional processes outside Europe and North America, as well as point to the need for a 'marriage' between area studies and disciplinary studies.
[53] See Ravenhill (1998: 159).

CHAPTER 1

GLOBALISATION AND ECONOMIC REGIONALISM:

A Review of the Theoretical Literature

1. Introduction

Many studies dealing with the resurgence of regionalism since the middle of the 1980s note that it has occurred in parallel with the rise of globalisation (Gamble and Payne, 1996; Coleman and Underhill, 1998; Grugel and Hout, 1999; Hveem, 2000, and Mittelman, 2000: 4). Although subject to a variety of definitions,[1] an underlying theme of globalisation is that it generates *increasingly intense interactions between nation-states and* societies through flows of goods, money, people, ideas, images and information, in the process making territorial boundaries less salient (Hurrell, 1995: 54). But, what is distinct about globalisation as opposed to other processes associated with the worldwide interaction of social forces is that it involves the reconfiguration of social space beyond notions of delineated territory (Hughes, 2000: 4). Thus, the relationship between globalisation and regionalism appears to be a paradoxical one. While globalisation de-emphasises boundaries, regionalism imposes them through defining a new, larger territorial space out of pre-existing, smaller territorial spaces, namely nation-states.[2]

The growth of regionalism since the mid-1980s against the backdrop of globalisation has, therefore, generated considerable scholarly interest in the relationship between globalisation and regionalism. The literature identifies two basic or ideal-type models of the globalisation-regionalism relationship depending on whether the relationship is

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[1] See Scholte (2000: 44-46).

[2] Nevertheless, the larger space is rarely if ever a new political unit or superstate. Even the European Union, the most advanced regionalist project cannot yet be termed a super-state or

conceived of as being accommodating or antagonistic. The former is the dominant model in the literature, conceptualising regionalism as a way station to globalisation, a means through which policymakers enhance the participation of their respective national economies in globalisation processes. Alternatively, regionalism represents an attempt by state or other actors to resist globalisation. The chapter advances the argument that the two basic models of the globalisation-regionalism relationship in the literature are theoretically limited, which consequently have implications for how they allow for the interpretation of empirical trends.

Although providing considerable insight into developments in the contemporary world economy, these basic models suffer two interrelated weaknesses. The conceptualisation of the state-market or economics-politics relationship is inadequate in both models. Moreover, firms are conceptualised as atomistic or individualistic rational economic agents, devoid of any social and political context. The latter consequently results in the neglect of what the dissertation considers to be a crucial distinction between foreign and domestic capital. This distinction is especially relevant in the developing world in general and Southeast Asia in particular. In these settings, domestic capital often performs vital social and political roles, often fulfilling distributive goals, while foreign capital addresses the growth priorities of national governments. The chapter advances a third model of regionalism – developmental regionalism – which is theoretically possible once a distinction is made between foreign and domestic capital. Developmental regionalism is intended to stimulate the growth of domestic firms in the face of globalisation pressures by providing domestic firms the means to expand through regionalism but with either temporary protection from, or temporary privileges over, foreign capital.

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political entity. It continues to remain an inter-governmental project although it has a high level of institutionalisation and supranational governance.

Before elaborating on these two ideal-type models and their limitations in Section 3, Section 2 first defines more fully the term globalisation. It draws out the predominant features of globalisation that impinge on the ways in which economic activity is conducted, particularly for the developing world. The next stage is to use this model of globalisation to explore why regionalism might emerge as a response, using the main models of the globalisation-regionalism relationship in the literature as the starting point for analysis. Based on this discussion, Section 4 discusses the key role of the domestic political economy in analysing regionalism, using the example of ASEAN as an illustration as well as to flesh out the dissertation's main propositions that are developed from the theoretical critique.

2. Conceptions of Globalisation

Globalisation has been defined in a variety of ways that emphasise distinct processes, key actors, causes and normative positions (Higgott and Reich, 1998). Some see it as the spread of cultures across the globe, while others emphasise the worldwide diffusion and assimilation of Western, specifically US values, norms and standards for both the economic and political spheres of life. Globalisation as a material economic phenomenon is often seen to be synonymous with internationalisation, or the expansion of economic activity across national borders leading to greater economic integration and interdependence between nation-states and societies. Still others regard it as a neoliberal economic process of liberalisation, deregulation and privatisation.

Hughes argues that these definitions do not capture the essential feature of globalisation, namely as a process that disengages human activity from territory (Hughes, 2000: 3-4). His point, earlier stressed by Scholte (1997b: 431), is that globalisation is qualitatively distinct from these other processes of universalisation, internationalisation and liberalisation because of its potential to "reconfigure social space away from and beyond notions of delineated territory" (Hughes, 2000: 4). Nevertheless, it is important to avoid the 'hyper' globalisation thesis that the world is moving inexorably towards a borderless world.[3] Moreover, the 'de-territorialisation' that is argued to be the essential feature of globalisation is still a limited phenomenon, with national borders continuing to constrain the unfettered flow of global market forces.[4] 'De-territorialisation' is perhaps confined largely to the world of global financial flows and the internet where finance and information flow instantaneously around the globe unconstrained by territorial borders and removed from territorial space.

Nevertheless, Hughes raises a crucial point about the tendency of globalisation processes towards the reconfiguration of social, including economic space beyond prevailing notions of territoriality, namely nation-states. But, what exactly is it about globalisation that has the potential to reconfigure economic space? More specifically, how is economic space being reconfigured? How might this relate to regionalism? To answer these questions requires an examination of the underlying drivers of globalisation. This exercise also provides us with a better understanding of the implications of globalisation for governments, business and other social groups, including in the developing world. The following discussion is structured around the three dimensions of globalisation – the material, institutional and ideational/cognitive – which mutually reinforce globalisation as a set of processes.

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[3] Ohmae (1990, 1995) is the most notable advocate of this thesis. Strange (1995) and Cerny (1990: 220; 1995: 597) make a weaker though related argument regarding the 'retreat' of the state – that states have become increasingly dysfunctional, losing the capacity to manage the national economy.
[4] The notion of 'de-territorialisation' comes from Scholte (1997b: 431) who conceptualises globalisation as the rise of what he terms 'supra-territoriality', when national borders are 'not so much crossed or opened as transcended'.

2.1 The Material Dimension of Globalisation

Historical similarities exist in patterns of trade, finance, and production between earlier periods and the present, post-1970 world economy, which is argued to represent most clearly the globalisation period (Oman, 1994: 33).[5] Yet, many students of globalisation point to the sharp differences in the volume, scope, speed, clustering and depth of the processes and interactions in the world economy between the two periods (Petrella, 1996: 64-66; Sjolander, 1996: 605-7; Higgott, 2000: 70). Contemporary global linkages are argued to be "organically different" due to changes in the "manner in which firms organise production and both cooperate and compete with each other".[6] This is a valuable point, because it draws attention to underlying firm-level dynamics that underpin globalisation processes and that also drive the particular ways in which economic space is reconfigured under globalisation.

The changing microeconomics of production and the new competition

One of the most important driving forces of globalisation is the diffusion and adoption of the post-fordist or flexible model of corporate and industrial organisation, particularly in the post-1970s world economy (Oman, 1994: 83-99).[7] Flexible production systems increasingly underpin the growing prominence of functionally integrated transnational production patterns that has been noted in the contemporary period (Dunning, 1993: 4; Oman, 1994: 97; Dicken, 1998: 175). Governments and firms concerned respectively

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[5] Other interpretations see globalisation as a continuing process of the last 100 years (Hirst, 1997: 410), a development dating from 1945-50 (Amin, 1996: 244-45), or emerging in its 'fully-fledged' form since around 1960 (Scholte, 1997a: 19).
[6] See the Research Agenda of the Centre for the Study of Globalisation and Regionalisation (CSGR) at the University of Warwick available at: http://www.csgr.org/agenda.html.
[7] Flexible production systems emphasise flexibility of the production process, of its organisation within the factory and of relationships with customers and with supplier firms. Dicken (1998: 165-72) and Oman (1994: 86-89) provide useful overviews of flexible and fordist production systems.

about economic growth and profitability find themselves having to respond in one way or another to the new competition associated with these changes in the way production is increasingly organised.

The turn to flexible models of production has been accompanied by a shift in the sources of wealth creation from natural assets such as unskilled labour, land and natural resources to created assets, particularly in the manufacturing sector (Stopford and Strange, 1991: 82; Dunning, 1993: 6; Lall, 1995: 6). Created assets, which are argued to be firm specific and thus, potentially mobile centre on information, technological innovation, as well as management and organisational competence. Although broad generalisations need to be made with care, since natural assets remain important in a number of economic sectors, it is also evident that technology and skills have become crucial in manufacturing, particularly in higher value-added activities (Dicken, 1998).

These changes in production dynamics also underpin the growing structural power of global capital. Developing country governments concerned about high value economic growth are increasingly reliant on the firms that possess 'created assets' to establish production activities in or involving their respective economies, underscoring the crucial importance of FDI in the world economy (Stopford and Strange, 1991: 1).[8] Production decisions, however, remain the purview of the global firms that governments are increasingly trying to attract (Petrella, 1996: 74). Competition for FDI among countries has, therefore, become far more intense since governments are all courting essentially the same types of firms to their respective economies than in previous times, having adopted broadly similar export-centred economic policies. The worldwide liberalising trend has,

[8] Firms themselves seek joint ventures, strategic alliances or mergers and acquisitions (M&A) in order to gain access to such assets belonging to other firms in a bid to remain competitive.

moreover, widened the location choice available to the firms who own these mobile assets (Stopford and Strange, 1991: 1; Dunning, 1993: 13-15). This makes competition for FDI likely to be more intense than ever even if the ability of a firm to relocate, once established, is more restricted than is commonly presumed. Countries will more than ever compete with each other to attract these mobile assets before they become location bound once production is established.

Although governments have always had to bargain with foreign firms, they were not totally helpless in that relationship when they possessed competitively priced natural assets that firms needed in production – land, natural resources or labour – or were able to use various policy instruments to attract foreign firms (Safarian, 1993: 53). Walter notes that investors, despite clearly preferring a completely unrestricted policy environment, nevertheless, privilege other factors above investment policies, such as "market size, growth prospects, geographical location, access to large regional markets, local infrastructure, human capital, and political stability" (Walter, 2000: 65). Of these, the importance of access to regional markets is especially relevant in the context of the dissertation, and one that may be engineered by governments through regional cooperation.

It is not only governments that need to respond to the new competition, however. Globalisation has led to a more complex business environment for firms and more intense competition, particularly as the "coordination and configuration of production chains has become the key to creating and sustaining competitive advantage" (Dicken and Yeung, 1999: 118). This imposes an enormous burden on emerging firms, especially in the developing world, that are new to the game and which also usually lack the ownership-specific assets to compete with well-established transnational corporations (TNCs) from the advanced countries in global competition.

Globalisation and the reconfiguration of economic space

Emphasising the underlying microeconomics of production not only reveals the growing competitive pressures on national governments and firms it also helps us understand how economic space is reconfigured in globalisation. While the seemingly logical answer would be 'global', meaning a global division of labour, this is not necessarily the case. Flexible production may well be contributing to a phase of economic agglomeration through the spatial concentration of production activity.[9] Globalisation is helping to re-define economic spaces beyond existing notions of territoriality, namely the nation-state, but not necessarily towards a global economic space. In short, both centrifugal forces (expansionary logic of capitalism) and centripetal tendencies (the agglomeration logic) co-exist in globalisation.

This is because flexible models of production are highly dependent on physical proximity between producers and suppliers on the one hand, and between producers and customers on the other (Oman, 1994: 17; Dicken, 1998: 241). Although this does not in any way imply in deterministic fashion particular forms of geographical clustering of production activities, it does explain the growing prominence of regionally, as opposed to globally, integrated production in the world economy (Rodan, 1993: 234; Oman, 1994; Dicken, 1998: 216-17; Studer-Noguez, 2000). These new forms of production, driven by the shifting corporate strategy of TNCs, are different from the cross-border economic activity that multinational corporations (MNCs) had engaged in previously during the 1960s and

1970s. Then, MNCs had exploited low labour costs in offshore production sites, producing for export to markets outside the region, usually to the industrial world and the MNCs' home markets. Although involving cross-border economic interactions, this form of internationalised economic activity did not reconfigure economic space in any fundamental way. Production was still organised on the basis of territorial nation-states, even if cross-border economic interactions were prominent. Since then, the dynamics of global production have altered, although this is not to suggest that the end of the state is anywhere near.

Critics of the globalisation thesis point to the regional clustering of economic activity as evidence against the emergence of a single global market place, and thus of globalisation.[10] On the contrary, this chapter argues that these are the very outcomes of underlying fundamental changes in the microeconomic dynamics of production associated with globalisation. Whether and where such regional clusters emerge depends not only on policy choices, but more importantly on the corporate decisions of firms that are, in theory at least, able to locate production anywhere in the world. Storper (1997) suggests that particular geographic locations are entirely substitutable apart from nominal cost differences. Because the assets required for production are located within firms themselves, firms are theoretically able to relocate worldwide, provided local conditions meet with their new production needs. As already noted, these are not necessarily the traditional cheap labour requirements, but rather those that support flexible modes of production, notably skilled human resources, modern infrastructure, and crucially for the dissertation, access to large, regional markets.

[9] This borrows from Paul Krugman's idea that firms tend to geographically cluster in particular regions due to increasing returns to scale, both internal and external to firms; lower transport costs; and high market demand (Krugman, 1991: 14-15).
[10] Hirst and Thompson (1992), and Weiss (1998: 176-7) employ this line of argument.

2.2 *Reinforcing Globalisation: The Ideational and Institutional Underpinnings*

One of the distinguishing features of the post-1970s world economy – the globalisation period – is that the changes in the material structures of production have occurred in combination with the spread of a single ideology, a shared consciousness of globalisation, and are underpinned by supportive multilateral rules (Higgott, 2000: 70). This makes globalisation a potentially powerful constraining structure constituting the "context of habits, pressures, expectations and constraints within which actions take place" (Cox, 1981/96: 97-98). Governments, business and other social groups have to respond to these forces in one way or another, but they cannot ignore them.

The neoliberal underpinnings of globalisation

Globalisation, far from being purely a material phenomenon, is sustained by a coherent set of by now widely practised neoliberal economic ideas. These ideas emphasise and advocate, among other things, a free market economy with limited government involvement in and control of economic activity through policies of liberalisation, deregulation and privatisation, as well as the ideal of market competition (Higgott and Reich, 1998).[11] These ideas have become especially prominent from the middle of the 1980s, and are widely practised in both the industrial and developing world (Biersteker, 1992) although they do not go unchallenged.[12] The pre-1970s internationalisation period, in contrast, was not associated with any consistent set of ideas about the best way to organise economic production. Neoclassical ideas about free trade and free markets often co-existed with beliefs about the benefits of greater state intervention in the economy (Hoogvelt, 1997: 135).

[11] Scholte (2000: 34-35) sets out the neoliberal underpinnings of globalisation.
[12] George (2000) discusses these emergent challenges.

Awareness, consciousness and perceptions of globalisation

While neoliberal ideas are a crucial component of and sustain globalisation, at a more fundamental level it is perhaps the growing instantiation of 'globalisation' itself and of global economic competition especially that influences how people respond to global economic change. Mittelman (2000: 4) notes that "globalisation has become normalised as a dominant set of ideas". Palan and Abbott (1996: 32) argue that perception of globalisation is possibly the main cause for changing patterns of behaviour today. Actors, in their view, respond not only to actual external pressures or changes, they are increasingly responding to *perceived* environmental change.

This is not an unusual point. Perceptions are, after all, of considerable importance in practical politics and policymaking (Barry Jones, 1995: 7). This is not to suggest that only one kind of behaviour is possible – that which entrenches globalisation. Ultimately, actors will respond to these perceptions in ways that are also governed by their location within distinct domestic social and political contexts. The point remains, though, that actors may respond in anticipatory fashion to the perceived needs and demands of global competition to stay one step ahead of the game even if there are no immediate or serious market pressures on them.

Multilateral organisations reinforce globalisation

While governments may be attracted to neoliberal economic ideas that promise simple recipes for creating economic wealth for societies – liberalisation, deregulation, and privatisation – it may not be possible for governments to select particular elements from this package of policy prescriptions while ignoring others, or even to reject them altogether. It is increasingly the case that international organisations, especially the World

Bank, the International Monetary Fund (IMF), and the WTO underwrite globalisation processes by developing neoliberal rules to which national governments eventually have to conform. Either these rules are binding on governments if they are members of the WTO, or governments have to subscribe to the neoliberal policies dictated by the IMF or the World Bank in return for financial assistance during economic crises. In short, the post-World War II period of 'embedded liberalism' (Ruggie, 1998: 72-76) has given way since the 1970s to what Hoogvelt (1997: 135) terms 'unembedded liberalism'.

Embedded liberalism allowed governments to intervene in the domestic economy to safeguard domestic social stability provided border barriers to international trade were progressively reduced. This compromise, which effectively allowed governments to deny market access and national treatment to foreign firms if they so wished, began unravelling over a period of time beginning from the early 1970s (George, 2000). It was only from the mid-1980s, however, that new rules were adopted, particularly in world trade that redefined, or more precisely markedly reduced, the purposes for which the government could legitimately intervene in the domestic economy, including restricting or discriminating against foreign firms. The new rules consequently advanced the interests of foreign firms, especially the TNCs that are the agents of globalisation. In short, the neoliberal ideas associated with globalisation have been increasingly institutionalised through a multilateral rule-based framework that has substantial authority over national governments, especially through the WTO.

To date, the WTO has been perhaps the pre-eminent institutional agent of globalisation, having a more extensive reach both in terms of geographical coverage and ever widening scope compared to other global institutions. Unlike the IMF, which enters the scene during times of economic distress when governments need emergency financial assistance, the

WTO is a more constant influence or constraint on national governments and firms. Not only does the WTO boast 142 contracting parties with others awaiting entry,[13] its functional scope has dramatically expanded and its authority sharply strengthened compared to its predecessor, the GATT. Since the GATT Uruguay Round negotiations of 1986-94 that launched the WTO, disciplines addressing intellectual property rights protection, market access and national treatment for foreign service firms, as well as trade-specific investment measures were explicitly incorporated into the multilateral trade regime. Rules on domestic competition and investment liberalisation are eventually expected to fall under the ambit of the WTO.[14] In these new issue areas, market deregulation is prescribed while state intervention in the market is proscribed, impinging directly on the government's ability to direct the market.

Moreover, the influence of the major (Triad) powers, namely the US, the European Union (EU) and Japan in multilateral organisations allows them to create and sustain the institutional conditions that permit economic actors, particularly their own TNCs to operate "in pursuit of maximum profit"(George, 2000: 22). This essentially means that advanced country firms, the TNCs in particular, are able to operate in a global environment that is almost tailor-made to their needs. On the other hand, emerging firms from the developing world are increasingly disadvantaged because their governments, while obliged to allow foreign firms domestic market access and other privileges, are being prevented from providing preferential treatment to domestic firms.

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[13] As at 26 July 2001.

[14] Working groups are currently studying the possibility of including investment and competition within the purview of the WTO. See the WTO official website: http://www.wto.org.

2.3 Conclusion: Globalisation as an Altered Structural Condition

Three points need to be kept in mind from the preceding discussion. First, while globalisation involves the reconfiguration of economic space, this does not necessarily imply either re-definition towards a global economic space or a single global division of labour, nor the absence of territoriality. Instead, the optimal economic space appears to be regional. This is not to suggest a functionalist line of explanation for the relationship between regionalism and globalisation. Nevertheless, the functional relationship between these two phenomena implies that corporate actors may respond positively to regionalism, particularly of the kind that further entrenches globalisation – open regionalism.[15] Globalisation, in other words, opens up space for agency, particularly on the part of state actors to influence corporate behaviour. The discussion also identified three sets of potential globalisation pressures that might result in the adoption of policies for regional cooperation – material economic pressures, cognitive influences, and institutional rules.

There is, however, no determining logic that points to open regionalism as the only policy response to globalisation. Countervailing tendencies may well result in other forms of regionalism, notably the resistance model. Much depends on how actors located within domestic social and political contexts respond to the structural pressures associated with globalisation on the one hand and to domestic political and social imperatives on the other that may collide with the globalisation logic. There are today significant counter-currents in the world economy that challenge both the neoliberal discourse and globalisation itself (Hveem, 2000; Mittelman, 2000). It is in this sense that globalisation is not a stable structure or a fully entrenched order, but one that can be challenged.[16]

[15] Open regionalism is defined in the next section.
[16] Challenges have increasingly been mounted against globalisation through street protests, for instance during the WTO Ministerial in Seattle in 2000, the 2000 IMF/World Bank meetings, the 2001 World Economic Conference at Davos and the June 2001 EU Summit in Sweden.

While it is true that globalisation is partly driven by technological innovations and the uncoordinated individual actions of rational economic actors out to maximise economic gains – the liberal economics reading – this is not the same as saying that globalisation is an inexorable economic force. It is necessary to recognise that globalisation is a process driven by the policy choices of a variety of actors – governments, business, international organisations and individuals who put in place the necessary institutional structures that support globalisation processes (Higgott, 1999: 27). What this also implies is the possibility for human agency, including that of governments, to manage the process or to attempt to shape it in preferred ways (Hirst and Thompson, 1995). It is out of such conscious policies that regionalism emerges in response to globalisation.

3. Globalisation and Regionalism

The preceding discussion suggests that the relationship between globalisation and regionalism may be complementary. The outward-looking nature of most contemporary regionalist projects leads many observers to surmise that these projects are designed to enhance the participation of member countries in globalisation processes (Gamble and Payne, 1996: 251-52).[17] This is the notion of 'open regionalism' in the current literature on regionalism, often contrasted with the 'closed' regionalism of the 1960s (Grugel and Hout, 1999: 10). It is the dominant theoretical model of the globalisation-regionalism relationship, as well as the most common form of regionalist project found in the contemporary world economy (Mittelman, 2000: 126). It is a model of regionalism that is underwritten by a liberal political economy perspective.[18]

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[17] Hettne (2000) provides a useful survey of the key features of contemporary regionalism. Previously, regionalism had been adopted to insulate countries from the world economy and to develop some measure of regional economic self-sufficiency.
[18] Breslin and Higgott (2000) offer an insightful theoretical critique of the regionalism literature.

3.1 Engaging with Globalisation: Open Regionalism

Open regionalism, as the term was originally used, meant a form of regionalism based on the principles of unilateral liberalisation rather than formally negotiated liberalisation, as well as non-discrimination, meaning that regional concessions were offered to both members and non-members alike (Drysdale and Garnaut, 1993: 187-88). While retaining these liberal economic underpinnings, the term is now used in a more general sense to characterise regionalist schemes that are fundamentally about engaging with globalisation and the global market. Therefore, regionalist schemes characterised as open regionalism do not generally involve a common external tariff,[19] while the exchange of preferences among regional partners is not accompanied by the imposition of new barriers to non-partners (Gamble and Payne, 1996: 251). Some scholars also define an open regionalist project as one whose members are willing to admit new members into the grouping provided they conform to group rules and arrangements (Grugel, 1996: 131; Mittelman, 2000: 113).[20]

While the discussion in the previous section suggests how globalisation may be functionally related to regionalism, this alone does not explain regionalism as a political choice. The liberal perspective in IPE that is the dominant theoretical perspective underlying the model of open regionalism provides only limited answers to this question. This perspective leads many authors to regard open regionalism as a project of regional

[19] Although MERCOSUR involves a common external tariff, it is, nevertheless, aimed at integrating the economies of its four member states – Argentina, Brazil, Paraguay and Uruguay – with the global economy. See Grugel (1996) and Phillips (2000).
[20] Compared to the closed projects of the 1960s and 1970s, virtually all regionalist projects in the world economy today have either already admitted new members or are in the process of admitting new members, or at least are committed to doing so sometime in the future.

liberalisation driven by concern with economic efficiency and competitiveness.[21] Alternative theoretical frameworks provide different understandings of open regionalism, however, which also point to distinct trajectories of regionalism rather than the idea that open regionalism tends towards ever-widening processes of regional liberalisation.[22]

A liberal political economy interpretation: neoliberal regionalism

Liberal political economy perspectives emphasise the primacy of economic incentives and the search for efficiency and competitiveness in explaining outcomes (Underhill, 2000: 13-14). Much of the literature on regionalism uses liberal insights to explain regionalism as a project of governments responding to the needs of corporate actors to improve competitiveness in global markets, using regional action to ride on globalisation (Grugel and Hout, 1999: 10; Hveem, 2000: 70-74; Mittelman, 2000: 121). Regionalism that is aimed at deep engagement with the process of globalisation is an example of 'meso-globalisation'.[23]

A liberal interpretation of regionalism also suggests that these projects are likely to include a strong deregulatory agenda associated directly with the regionalist scheme or underpinning it through national neoliberal agendas, both aimed at reducing the state's role in economic life, which is expected to yield efficiency gains.[24] The effect of such actions is to markedly reduce transaction costs for firms engaged in transnational economic activities across national borders. In short, this form of regionalism – neoliberal regionalism – subordinates the economies of member countries to what are seen as the

[21] See the discussion in Grugel and Hout (1999: 10); Mittelman (2000: 112-13) and Hveem (2000: 71).
[22] See Mittelman (2000: 113) on the latter point.
[23] See Phillips (2000: 286, fn 7) who attributes the idea of 'meso-globalisation' to Richard Higgott.
[24] Phillips (2000) and van Apeldoorn (2000) note this trend respectively in Latin American regionalist schemes and in European integration.

beneficial forces of global markets. It is a regionalism that is informed by neoliberal economic ideas. Open regionalism and neoliberal regionalism are often regarded as synonymous in the literature.[25]

A strict liberal interpretation would, however, see global liberalisation to be superior to regional liberalisation (Mittelman, 2000: 126). Even though regionalism and globalisation may be related functionally through changing production dynamics, global liberalisation would ideally provide a global economic space for TNCs. Even if their preference is to organise production regionally, global liberalisation allows corporations maximum choice about where to invest and in whatever spatial configuration best accommodates the firm's needs. This is borne out by actual trends in the world economy. While global corporations today tend to organise production on a regional basis, locating regionalised production operations in different parts of the world, this is usually part of a global strategy. A classic example is Ford Motor Company, whose global corporate strategy is based on a number of distinct regional production operations located worldwide (Studer-Noguez, 2000).

The regime literature (neoliberal institutionalism), a variant of the liberal theoretical perspective, provides an answer to the 'why regionalism?' question that strict liberal perspectives might find difficult to answer without resorting to functionalist logic. For regime liberals, firms and governments opt for regionalism because cooperation is easier to negotiate with smaller numbers than would be the case for negotiating global liberalisation (Oye, 1985). Regionalism is a solution to the collective action and transaction costs problems that impede cooperation among large numbers. Moreover, by creating both an incentive and a potential bargaining tool for further negotiations, regional

[25] See, for instance, Mittelman (2000: 112-13, 126).

cooperation can potentially advance global liberalisation (Oye, 1992). Liberal readings of regionalism thus see the phenomenon as a building block to global liberalisation.

This particular interpretation suggests that we are also likely to see ever-widening processes of regionalism as more and more nation-states are brought into existing regional projects in an effort to build up global liberalisation. The current process of enlargement in the EU, although primarily explained in security terms, can also be accommodated within a liberal economics interpretation of extending the original regional market outwards, though within prevailing political and cultural constraints. Hemispheric cooperation in the Americas can be interpreted in a similar light, as the outward extension of the original US-Canada Free Trade Area and NAFTA.

Liberal readings of regionalism thus emphasise the regional project's embrace of global market forces and its intended engagement with globalisation processes. In short, the political decision to participate in regionalism is made in order to subordinate the national economy to global market forces. Regionalism thus involves very little purposeful political action by governments of states to alter or manipulate prevailing patterns of global economic activity. The implicit assumption in liberal perspectives is of patterns of economic activity generated by spontaneous market forces and thus, outside the scope of human agency (Barry Jones, 1995: 38; Underhill, 2000: 13-14).

Alternative perspectives in IPE, the economic realist approach for instance, provide different understandings of open regionalism, which consequently have implications for the precise form of regionalist project that emerges as a result of globalisation and regionalism's future trajectory. Economic realism recognises that state actors can and often do manipulate inter-state politics to try and influence some aspect of the international political economy. While the actual success of such agendas may be limited, especially in the case of developing countries, nevertheless by allowing for purposeful action the economic realist perspective re-introduces the political into liberal frameworks of regionalism.

Economic realist perspectives: modifying understandings of neoliberal regionalism

The economic realist perspective is analytically useful for the study of the globalisation-regionalism relationship because it provides for the "possibility of purposeful action to alter or transform prevailing patterns of economic capability and advantage" (Barry Jones, 1995: 31). It suggests that even in the case of open regionalism where governments seek engagement with the global economy, governments may be using regionalism in a purposeful manner to influence particular aspects of globalisation processes to benefit regional members. It encompasses the notion that governments are not always totally helpless in the face of globalisation, and may find the space to engage in actions through cooperation that alter or interfere with global market outcomes in certain desired ways.

Mittelman (2000: 133) alludes to this when he suggests that the logic of global capital, namely its tendency to engage in regional production, offers nation-states an incentive to collaborate "to attain market shares and augment trading and investment opportunities". Economic realist frameworks emphasise this particular point – that governments may seek to consciously manage inter-state relations in order to transform prevailing patterns of global economic activity to benefit their respective states. Regional cooperation is one means of doing so. It may be used to re-direct beneficial global economic forces, global capital for instance, to the region in question using the instrument of the single regional market to which corporate actors are likely to respond positively, as the preceding discussion on globalisation suggests. In such instances, open regionalism is driven less by narrower concerns with economic efficiency and more by concerns with attracting FDI, which is a key source of economic growth for many countries. It is an agenda that is most likely to appeal to developing countries.

Developing countries, in particular, may respond to the structural power of transnational or global production capital[26] by actively using regionalism to attract new production capital to the region and through that process to individual national economies. Governments are likely to respond with a policy of regionalism to external developments that are seen as having the potential to divert investment away from the national economy, provided they recognise the potential of regionalism in retaining or attracting production capital. Policymakers may become aware of the potential of regionalism as a magnet for FDI once they realise that foreign investors are registering strong interest in and are actually investing in regionalist projects established elsewhere.

Developing countries, usually with limited indigenous capabilities for global production, often look to attracting TNCs that do possess these assets to their respective economies. In a situation where FDI can theoretically locate in a variety of locations, developing countries will want to prevent the potential loss of these wealth-creating assets owned by TNCs to other locations. TNCs may not be involved in direct lobbying or bargaining with governments, but policymakers are likely to make policies with this thought – the need to attract or retain global capital – in mind. Although this may be accomplished though providing a more liberal national regulatory environment for investors, market size and access to large regional markets are among the main criteria now influencing the decision about where to invest, rather than the national FDI regime. Engaging in regional

[26] The structural power of capital rests on the ability of capital owners to deny investment (Lindblom, 1977).

cooperation allows governments to exploit global capital's functional preference for regional markets.

The economic realist interpretation: embedded neoliberal regionalism

Regionalist projects driven primarily by the desire to attract global capital are instances of open regionalism to the extent that they are about engaging with globalisation processes. In that sense both economic realist and liberal theoretical perspectives provide similar readings of regionalism. These contrasting perspectives offer distinct views on two issues, however – the precise features of the regionalist project and its likely future trajectory.

Regionalist projects designed primarily to attract FDI need not necessarily encompass the strong neoliberal, deregulatory agenda often associated with neoliberal regionalist projects driven by efficiency concerns. The overriding concern in the former is more broadly with economic growth.[27] Efficiency is attained to the extent that the incoming capital operates efficiently, but the regionalist project is not necessarily underpinned by neoliberal ideas nor associated with a strong neoliberal agenda. It was already noted that foreign investors privilege other factors above the policy regime when making investment decisions, although they would clearly prefer less to more government intervention in markets. Provided key areas of economic life that are crucial for foreign investors are relatively unrestricted, such as trade flows and financial regulations on profit repatriation, investors appear able to live with some degree of government restriction in markets.[28] Regionalism primarily motivated by the desire to draw in FDI may, therefore, display only limited

[27] While the relationship between efficiency and growth is a close one, growth can, nevertheless, proceed in the presence of some level of economic inefficiency by simply increasing inputs of the factors of production, notably labour or capital. Efficiency pertains to maximising output and returns from a given amount of inputs. Paul Krugman's claim about the myth of the East Asian miracle rests on this distinction. See Krugman (1994).

neoliberal characteristics. These projects are best termed 'embedded neoliberal projects'.[29] While these projects are, nonetheless, instances of open regionalism designed to remain engaged with global market forces, they continue to retain some degree of government intervention in markets.

An economic realist reading of open regionalism also suggests that the prospects for extending the regionalist project to include new members will be contingent. Since regionalism is directed at offering global capital a distinct functional space of production, extending the project to new members could weaken the distinctiveness of the original regional project. This will be especially the case if the new member is itself a very attractive site for FDI, potentially able to draw in substantial amounts of incoming FDI with limited spillover benefits to other members in the project through vertical and horizontal production linkages.

For instance, regional projects involving a group of small countries may not always benefit from the membership of a large country like China which itself effectively offers foreign capital a 'regional' site of production by virtue of its size and internal industrial complementarities. There is a significant possibility that foreign investors may prefer to establish production networks within the Chinese territory, but trade the resultant output to the other members of the regionalist scheme, thus defeating the purpose of the regionalist

[28] This does not necessarily stop TNCs from lobbying for neoliberal policies, particularly through multilateral organisations.
[29] The notion of 'embedded neoliberal' regionalism is borrowed from van Apeldoorn (2000: 241) who uses it to describe the emerging European regional order in which the state continues to play a role in the provision of public goods like education and infrastructure. The original term comes from Ruggie (1998: 72-76).

exercise for its original members.[30] The benefits of extending the regional project to new members are not unequivocal, unlike the case of efficiency-driven neoliberal regionalism.

Key limitations of the basic model of open regionalism

By moving beyond the dominant liberal interpretation of open regionalism and drawing on economic realist insights, the discussion identified two variants of the open regionalist model. The distinction between them is analytically significant because they offer contrasting predictions about the future trajectory of open regionalism. Economic realist interpretations of open regionalism are moreover useful because they focus analysis on FDI as a key analytical variable. Domestic capital is invisible in the analysis, however. This stems from the systemic focus of the economic realist approach and the tendency by scholars to adopt the unitary state assumption, which means the domestic political economy is not an explicit focus of analytic attention. The liberal perspective does not even make a distinction between domestic and foreign capital, regarding all business actors including firms as individual, rational economic agents engaged in maximising their earnings. As will be seen below, a distinction between foreign and domestic capital can give rise to a third model of regionalism in which domestic capital is a key analytical variable.

Despite the analytical leverage provided by the economic realist perspective, both liberal and economic realist approaches derive the motivation for regionalism in developments at the systemic level, the former in material pressures from global markets and the latter in inter-state power political competition (Barry Jones, 1995: 31-32). The latter approach suggests that state authorities seek to consciously manipulate patterns of international

[30] Although there is always an element of competition among the members of a regional project for incoming FDI, particularly for high valued-added production, the presence of complementarities

economic activity for strategic purposes. While this may be a relevant proposition in the case of the major powers and potential strategic rivals like the US, Japan, or the EU, it applies less well to small, developing countries. The latter are more likely to be driven by concerns rooted in the domestic political economy.

Many developing countries are preoccupied by domestic political priorities that are broadly centred on the fragile nature of political legitimacy,[31] both of the regime[32] or political system and of the governing elite (Ayoob, 1995: 9-15). In these societies, governments often attempt to direct economic development for social and ultimately political purposes. Political elites in many developing countries derive legitimacy from their ability to deliver economic growth in their countries and improve the wealth of citizens, which often also includes a distributive agenda. Foreign economic policies, including regionalism, often fit into such domestically derived goals and priorities. Integration of the domestic political economy with the economic realist perspective can therefore provide richer forms of economic realist analyses.

3.2 Regionalism as Resistance to Globalisation: Emphasising Domestic Politics

An alternative ideal-type model of the globalisation-regionalism relationship in the literature explicitly brings in the domestic level, and is thus a useful corrective to the basic model of open regionalism that focuses on systemic level forces only. Although encompassing a range of variations, the essential feature of the basic resistance model is that it seeks to preserve through regionalism particular forms of national policy

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among members usually ensures some form of balance is achieved.

[31] Political legitimacy is essentially the 'right to rule'. See Barker (1990: 11) for a fuller definition.

[32] 'Regime at the state level usually refers to the existing political system that defines the collective interests of society and decides the way power is allocated. See Case (1996: 4). It is to be distinguished from the notion of international regimes in the IR literature that refers to the

instruments or domestic social and economic arrangements that are difficult to sustain individually amidst globalisation (Mittelman, 2000: 116-30).

Domestic level dynamics: the central role of legitimacy

The resistance model thus emphasises concern with non-economic or social values like distribution and social justice as the main driving force for regionalism, in contrast to the basic model of open regionalism that emphasises growth and/or efficiency as a key driving force. Although systemic forces – globalisation – do come into the picture, the response to them – resistance regionalism – is mediated through the domestic political economy. Attention moves beyond a focus on economic actors, or actors with purely economic interests only to emphasise non-state actors or social groups apart from state and corporate actors as well as domestic political institutions and processes.

Legitimacy is usually a key concern in this form of regionalism (Hveem, 2000: 75-78; Mittelman, 2000: 116-30). Governments, deriving political legitimacy from their capacity to undertake traditional social responsibilities for the societies they govern, may be compelled to turn to regional collective action as the only viable option to maintain national social/economic arrangements like the welfare state apparatus (Hirst and Thompson, 1996: 162). Globalisation increasingly appears to make such arrangements more costly to maintain at the national level. This is why it has been suggested that the future of social democratic economic systems and re-distributive policies in European countries lies in a European regional project (Kurzer, 1993: 254).

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framework of rules, procedures, expectations and norms that govern relations between states in the international system.

Although the resistance model is a theoretical possibility, most instances of regionalism in the world economy are examples of open regionalism, particularly of the neoliberal variant (Mittelman, 2000: 126). Nevertheless, there is the possibility of a dialectical process emerging out of globalisation to challenge the neoliberal trend in regionalism. The resistance model may consequently emerge as an empirical feature as well as a theoretical alternative. It may also emerge as regional projects that were originally designed to engage fully with globalisation are themselves challenged by domestic groups suffering the effects of regional liberalisation, particularly if social protection or compensatory measures are unavailable as a result of neoliberal approaches to market liberalisation (Higgott, 2000: 80-81). Neoliberal regionalism consequently may challenge the authority and legitimacy of governments under these conditions. In such instances, governments may attempt to withdraw from the regionalist project, or alternatively seek to change the project's original terms and conditions. The tendency to use regionalism to ride on globalisation may not be a lasting one (Hveem, 2000: 71).

Regionalism should, therefore, not be viewed only in static terms as the outcome of a one-off decision to cooperate. New forms of regionalism could emerge from what was originally a neoliberal project if the re-negotiation option is adopted. How the original regionalist project might eventually be transformed will also depend on dynamics at the regional level where re-negotiations and bargaining take place between governments, especially when the desire to re-negotiate the original project is not shared by the other partners in the project.

Domestic level dynamics and the politics-economics relationship

One of the shortcomings of the 'resistance' or legitimacy model is its imposition of a separation of economics and politics by conceptualising growth or efficiency (economics), the primary concern of open regionalism, and legitimacy (politics) as opposed to one another. This is because the analysis of domestic politics in the resistance model does not extend to uncover the bases of legitimacy. Such an exercise is likely to reveal that in certain political contexts, growth/efficiency and legitimacy may be closely interrelated, and complementary rather than opposed. Much, therefore, depends on the sources of political legitimacy in a particular society. The ASEAN case, for instance, illustrates this point particularly well.

Economic performance is often a crucial basis of political legitimacy in the ASEAN countries where elite governance political systems dominate, and where political legitimacy remains fragile (Castells, 1992: 59-60; Alagappa, 1995: 330). In these countries, high rates of economic growth not only satisfy mass aspirations to material well-being they also allow elites to maintain their right to rule (Case, 1996: 18). In such instances, the presumed tension between legitimacy and growth/efficiency is either relieved or at least, reduced. The alliance between state elites and transnational foreign capital, for instance, far from being a source of legitimacy crises, instead can help prevent such crises from developing by sustaining national competitive advantage in the global economy (Yeung, 2000: 140). Concern with legitimacy could thus entrench open regionalist projects, if these contribute to growth rather than result in challenges to them. This points to the need to pay closer attention to domestic political dynamics that specify more clearly what the bases of legitimacy are, in particular the relationship between growth and distributive priorities. Clearly, the domestic level is crucial, mediating between forces of globalisation and regional outcomes.

3.3 Developmental Regionalism: Privileging Domestic Capital

As already discussed, the literature identifies two ideal-type models of the globalisation-regionalism relationship, with the open regionalist model dominant in the world economy. In theoretical terms, open regionalism privileges globally oriented capital as a key analytical variable. Regionalism is designed primarily to advance the competitive position of business in global competition (the liberal economic interpretation) or to attract FDI to the region (the economic realist interpretation).[33] Unlike the resistance model whose proponents seek to resist globalisation, the advocates of neoliberal and open regionalism fully accept engagement with globalisation, although those concerned with attracting FDI attempt to manipulate global market forces through regionalism.

This chapter advances a third model of regionalism that is theoretically possible once a distinction is made between foreign and domestic capital. The proponents of this type of regionalism, usually national governments, are not necessarily resisting globalisation through regionalism. They do not fully accept the anticipated hegemony of foreign/global firms that is associated with globalisation, however, and attempt to support the development of domestic capital through regionalism. This form of regionalism, which I term developmental regionalism, is likely to be relevant in the context of the developing world in general and Southeast Asia in particular. Deriving from the notion of the East Asian developmental state, developmental regionalism, thus, encapsulates the developmental state idea of state intervention in markets to promote national development agendas, particularly to build up domestic or national firms and more broadly, indigenous

[33] This is not to imply that FDI is never a concern in the former, but simply that the primary concern of neoliberal regionalism is to stimulate economic efficiency. The economic realist interpretation, on the other hand, regards the need to attract FDI as the primary concern of policymakers.

industrial and technological capabilities.[34] Developmental regionalism, it is argued, is designed to stimulate the growth of domestic capital in the face of globalisation through providing domestic firms with the means to expand through regionalism, but with either temporary protection from or temporary privileges over foreign capital. The model, therefore, employs strategic trade insights from the international economics discipline as its theoretical base, rather than neoclassical economics.

Insights from strategic trade theory

Strategic trade insights suggest that it is not only the large, regional market that is crucial in providing the conditions for business to expand and become internationally competitive, it is the *protected* regional market that is key.[35] By employing selective protection/privileges (preferential treatment only to group members) and regional market expansion (creation of the larger regional market), governments can use regionalism to help develop competitive domestic industries to survive global market competition and eventually become world market leaders. This line of argument is based on theoretical insights drawn from one of the three main strategic trade models found in the literature.[36] Paul Krugman's 'import protection as export promotion' model reveals that when a domestic firm is given a privileged position in one market, usually the home market, it enjoys an advantage in scale over foreign rivals that enables the firm to realise 'learning by doing' benefits (Krugman, 1984). Size is an implicit part of this model, and it suggests

[34] See Johnson (1999) and Woo-Cumings (1999) on the developmental state.

[35] Strategic trade theory derives its conclusions from assumptions that depart from those of neoclassical trade theory: that markets display increasing returns to scale, that learning effects or the experience of firms is important, and that technological innovations matter (Helpman and Krugman, 1985: 3; Brander, 1986: 25; Krugman, 1986: 8). Under these imperfect market conditions, an interventionist trade policy is shown to secure welfare gains for the country (Brander and Spencer, 1985; Krugman, 1986: 12-14; McCulloch, 1993: 49-50).

[36] A useful discussion of these models is found in Matthews and Ravenhill (1994).

that a larger protected or privileged home market would potentially offer greater dynamic scale and learning effects to the privileged firm than a smaller market.

Strategic trade insights, thus, suggest that developmental regionalism is not always or necessarily about governments "putting a lifebelt around a declining industry" (Higgott, 1987: 27). Instead, they point to the potential role of governments in facilitating the competitiveness of domestic firms through temporary protection, or through providing them temporary privileges, before exposing them to global market competition. This is part of the broader argument in the strategic trade literature that sees a role for national governments in actively laying the basis for high quality economic growth by using a trade-industrial policy mix to develop the international competitiveness of domestic firms (Reich, 1983; Krugman, 1986; Zysman, 1988). While strategic trade theory provides the economic rationale for developmental regionalism the answer as to why political actors would seek to nurture domestic capital must be found elsewhere.

Domestic capital and its social/political context

It is difficult to integrate strategic trade insights with liberal theoretical perspectives because of a fundamental tension between the two approaches. Strategic trade theory emphasises (and advocates) a central role for an activist government, while liberal approaches reject any such notion. Liberal perspectives are also unable to accommodate developmental regionalism simply because they do not make a distinction between domestic and foreign capital. Liberal approaches regard firms as atomistic, devoid of any social or political context (Underhill, 2000: 14). Business actors are, nevertheless, part of social wholes and consequently have roles beyond mere economic agents engaged in profit-making activity (Murphy and Tooze, 1991: 19-20). It is only by considering the distinct role of domestic capital in the domestic political economy that this model of developmental regionalism may be recognised as a distinct form of regionalism, rather than merely as inconsistencies in open regionalism or as instances of protectionism.

The open regionalism model does not make an adequate distinction between foreign and domestic capital, although foreign capital is privileged in the FDI variant. If a distinction is made at all, it is to view domestic business as agents of protectionism likely to resist regional (and global) liberalisation. This is also because of the model's focus on the industrial world in which domestic capital is likely to be relatively well developed, unlike the situation in the developing world. *In developing countries, where domestic capital is usually not as well developed as foreign capital but often plays a crucial political role, governments may well respond to globalisation in ways that attempt to preserve and nurture domestic capital.* This reflects one dimension of distribution, involving the selective direction of economic gains to domestic capital vis-à-vis foreign capital. Although it may be increasingly difficult to distinguish business in terms of its nationality – the 'who is us?' question posed by Robert Reich (1991: 304)[37] – such a distinction, nevertheless, remains relevant in particular political contexts, as is the case for developing countries that do consciously make this distinction for various reasons.

Developmental regionalism and its underlying strategic trade insights are easily accommodated within economic realist perspectives, which allows for an activist government role in both the domestic and external spheres. Why governments would do so depends on domestic political economy dynamics, as already noted in the introductory chapter, rather than in inter-state power political competition.[38] The explicit consideration

[37] Reich (1991: 136-53) writes of the "coming irrelevance of corporate nationality".
[38] Hence, the model of developmental regionalism advanced in this dissertation is distinct from the notion of neomercantilist regionalism, the latter seeking to build up the national economy through protection and by excluding foreign firms, primarily to gain international strategic/political power.

of the domestic level in analysis can provide insights into the social/political context for domestic capital, and thus offers an understanding of why political actors might wish to privilege domestic capital over foreign capital.

Gamble and Payne's model of strategic trade regionalism

Before proceeding further, it is necessary at this point to take a closer look at Gamble and Payne's notion of strategic trade regionalism (Gamble and Payne, 1996: 252). Superficially, their idea of strategic trade regionalism appears to be similar to the model of developmental regionalism advanced in this chapter. The authors argue that all open regionalist projects are informed by a strategic trade view. They see regionalism as a means to enable industries to develop their competitiveness through protection of selected sectors as well as through supply-side policies like training, research, public procurement, and infrastructure provision.

There is, however, a fundamental difference between the model of developmental regionalism advanced in this chapter and the idea of strategic trade regionalism proposed by Gamble and Payne. Crucially, the latter does not make a distinction between domestic and foreign firms, with selective protection to industries provided only through the restriction on imports from outside the region.[39] Thus, both domestic and foreign firms are either both protected or privileged through regionalism. Theoretically, these firms are also able to compete with each other within the regional market once the foreign firm has established operations in the region. Developmental regionalism, on the other hand, is explicitly about nurturing *domestic* firms through either temporary protection from, or temporary privileges over, foreign firms. It encompasses the features of both open

[39] Imports from outside the region are restricted through the higher prices that must be paid for them compared to imports from regional partners.

regionalism as well as the resistance model, and is, therefore, distinct from the notion of strategic trade regionalism advanced by Gamble and Payne that is fundamentally a model of open regionalism.

Mittelman's model of development integration

Mittelman's (2000: 116-17) development integration model of regionalism is also fundamentally distinct from the notion of developmental regionalism advanced here. Development integration, according to Mittelman, links trade integration with state attempts to promote coordinated regional industrial development. It is a model that clearly reflects the sentiments of the first wave of 'closed' regionalism of the 1960s and 1970s, particularly as it is implicitly underpinned by the idea of import substitution "to redress external dependence" (Mittelman, 2000: 117). In fact, ASEAN itself adopted this form of regionalism during the 1970s and 1980s, albeit unsuccessfully. State coordination of regional industrial projects that is found in Mittelman's development integration model is *not* a feature of developmental regionalism, which is about nurturing domestic capital through the strategic provision of selective privileges over foreign capital.

5. Globalisation and Regionalism: Incorporating Domestic Politics

The discussion so far suggests that globalisation, while structuring the external environment for countries and providing the initial impulse towards regionalism, cannot bear the full analytical burden in explaining regional outcomes. Regionalism may be one of three basic types, namely open regionalism (either a neoliberal or embedded neoliberal form), a resistance model, or a developmental version. Which project ultimately emerges is determined at the domestic level, where the domestic social and political setting mediates globalisation in significant ways. Milner, in fact, suggests that the domestic level is paramount because "cooperation is a continuation of domestic political struggles by other means" (Milner, 1997: 10). Domestic politics alone, however, cannot bear the full analytical burden as Milner suggests though she makes a valuable point about the importance of domestic politics. A domestic politics based explanation of regionalism would have to account for the simultaneity of domestic developments in all regional partner countries that would induce national governments to act jointly in a regional response.

Nevertheless, based on the preceding discussion, a key assumption in the dissertation is that governments respond to essentially domestic political constituencies in the first instance, on which they rely for political support. The particular domestic political economy setting often influences the way international events are interpreted by policymakers and other groups and their potential impact assessed. Policy choices in response to external developments are also made with one eye on their potential impact on domestic political dynamics, including their distributional implications. In short, while the systemic level may well provide the initial trigger or impulse, domestic political dynamics mediate the final outcome. The importance of the domestic level is best illustrated by reference to the specific case of ASEAN.

4.1 Domestic Politics in ASEAN: The Elite Governance Model

Domestic politics in the core ASEAN countries is best conceptualised as a system of elite governance, which is most usefully viewed as a project whose principal aim is to maintain elite power, autonomy and exclusivity (Case, 1996: 20; McCargo, 1998: 127). Although the domestic political systems in these countries are not identical, nevertheless, the dynamics of the domestic political economy all share the basic features of the elite governance model. Notably for the dissertation, elite governance political systems are characterised by tension that potentially exists between the growth and distribution imperatives inherent in these systems. Both sets of priorities relate to political legitimacy in these societies, which remains contested in the core ASEAN countries (Alagappa, 1995: 330). As already noted, growth/efficiency and distribution are the key driving forces of the three models of regionalism discussed in the previous section. The former drives the turn to open regionalism while concern with social equity underpins the resistance model. Developmental regionalism is driven by concern with both growth and the distribution of economic benefits to domestic capital.

Economic growth and elite governance

The tension between growth and distribution in elite governance systems emerges from the bases upon which elite rule, and its political legitimacy, is maintained.[40] In elite governance systems, political competition is usually restricted to elites, and governance is generally the function of "a narrow set of interlocking elite interests" (McCargo, 1998: 126).[41] Thus, a core foundation of elite rule is elite unity, making elite accommodation a vital task in domestic politics (Case, 1996: 9-33). Economic growth is key in this regard. Additionally, economic growth also undergirds the second pillar of elite governance systems, namely the relationship between governments and citizenry. In these settings, economic growth secures mass satisfaction through material wellbeing. While ruling elites have been known to maintain their position and to ensure a basic level of regime stability while blocking economic growth, their failure to deliver economic growth may be

[40] Political legitimacy, particularly of ruling regimes continues to be problematic in the core ASEAN countries, although in now democratic countries like Thailand and the Philippines it is the legitimacy of incumbent governments rather than the democratic regime that is more often contested (Alagappa, 1995: 330-33; Sukatipan, 1995: 221).

[41] Elites may be defined as "persons who are able, by virtue of their strategic positions in powerful organisations, to affect national political outcomes regularly and substantially" (Burton *et al*, 1992: 8). They are the principal decision-makers in the largest or most resource-rich political, governmental, military, professional, communications and cultural organisations in society. State elites gather at the apex of the state apparatus, and may be usefully divided into governing elites, bureaucratic elites, and military elites. Not all these component elites are important across the

politically damaging over time (Case, 1996: 18). This can occur through mass challenges and/or through a breakdown in elite unity.

In less than democratic political systems where the means for registering mass dissatisfaction are limited, economic grievances stemming from economic recession and crisis often give rise to protest actions by middle and lower income groups. Unlike elite groups, middle and lower income groups may be controlled by repression. Nevertheless, economic crises provide new opportunities to political oppositions or opposing elite factions to draw adherents from these latter groups and, thus, to challenge the prevailing regime and/or the ruling incumbents by linking adverse economic conditions to the exclusionary nature of the present regime (Haggard and Kaufman, 1997: 268).

Even though economic distress is not the primary source of factional or inter-elite conflicts, it is likely to exacerbate them. Fewer internal divisions within the ruling elite are likely when economic growth is strong. Declining economic performance often disrupts the political bargains rulers typically forge with other elite groups in society, for instance the business elite (Case, 1996: 17-20).[42] Rulers often co-opt business elites as partners in economic development by providing them with the broad conditions for growth that business actors typically seek. In turn, business groups not only spearhead economic growth they can also constitute a significant support base for rulers, especially in the case of domestic or national business interests in patronage-based polities.[43] The defection of

different ASEAN countries, while their importance can also vary within a country over time. See Case (1996) and McCargo (1998).

[42] Business or economic elites are essentially the owners and managers of private capital that are crucial in national investment, production and development processes. These elites often head financial, commercial, landed or industrial organisations.

[43] In patronage-based political systems, political elites grant special privileges to favoured individuals or firms in return for material and political support. Crouch (1986) provides a useful discussion.

business partners in such settings can leave incumbents politically weak not only through loss of both the source of growth in the economy as well as investor confidence but also of a vital political (and often material) support base for ruling incumbents. The end result is a weakening of elite cohesion and the power base of incumbent elites, while opposition groups gain from the defection of business and other elites previously aligned with the incumbents (Haggard and Kaufman, 1997: 267-68).

The challenges posed to ruling elites by declining economic performance have been amply demonstrated in the case of Indonesia and Malaysia. In Indonesia, political turmoil and the ousting of incumbent ruling elites quickly followed financial and economic troubles as a result of the Asian financial crisis that began in mid-1997. Malaysia too has witnessed substantial elite cleavages as a result of the financial crisis, although an emergent mass challenge to the ruling incumbents has been contained (Khoo, 2000). In short, economic growth allows elites to maintain their right to rule, and by doing so, ensures regime stability (Case, 1996: 4-18; McCargo, 1998: 127).

Distribution, elite cohesion and elite governance

At the same time, the picture is complicated by the imperative of distribution that is also inherent in elite governance systems. Very simply, distribution involves the selective direction of economic benefits, income and rents[44] by government elites to particular firms, groups or individuals who would not otherwise have received these gains through the undirected working of the free market. Apart from growth, distribution is also key to maintaining cohesion among elites through the distribution of economic benefits to politically favoured groups or individuals. Elite accommodation, as already noted above, sustains the political position of incumbent elites since elite cleavages or defections by key elite partners, notably business elites, opens up space for political challenge to incumbents. The absence of elite accommodation and unity is potentially a prelude to regime change (Haggard and Kaufman, 1997).

In addition to distribution to serve particularistic ends and thus ensure elite accommodation, distribution can also serve broader political goals, as a means towards some form of equity in society. In Malaysia, ruling elites favour the majority ethnic Malay community with material entitlements through the ethnic-based distributive policy, which is crucial to the political legitimacy of the Malay-dominated political regime (Crouch, 1996: 24).[45] Policies to ensure some measure of income support to farmers who may be a key constituency for ruling elites, for instance through maintaining restrictions on imports of cheaper agricultural products, is another instance of distribution for broader political goals rather than distributing benefits for particularistic ends. In these instances, distribution or broader social equity considerations is also vital for perpetuating elite rule and the stability and security of the regime.

While government policies for distributing economic benefits to politically important individuals, firms, or groups do not necessarily mean the economy is on course towards economic decline, distributive policies often involve trade-offs with the growth imperative. Trade-offs are especially likely when economic rents are created through artificial restrictions on market competition by governments, which could undermine

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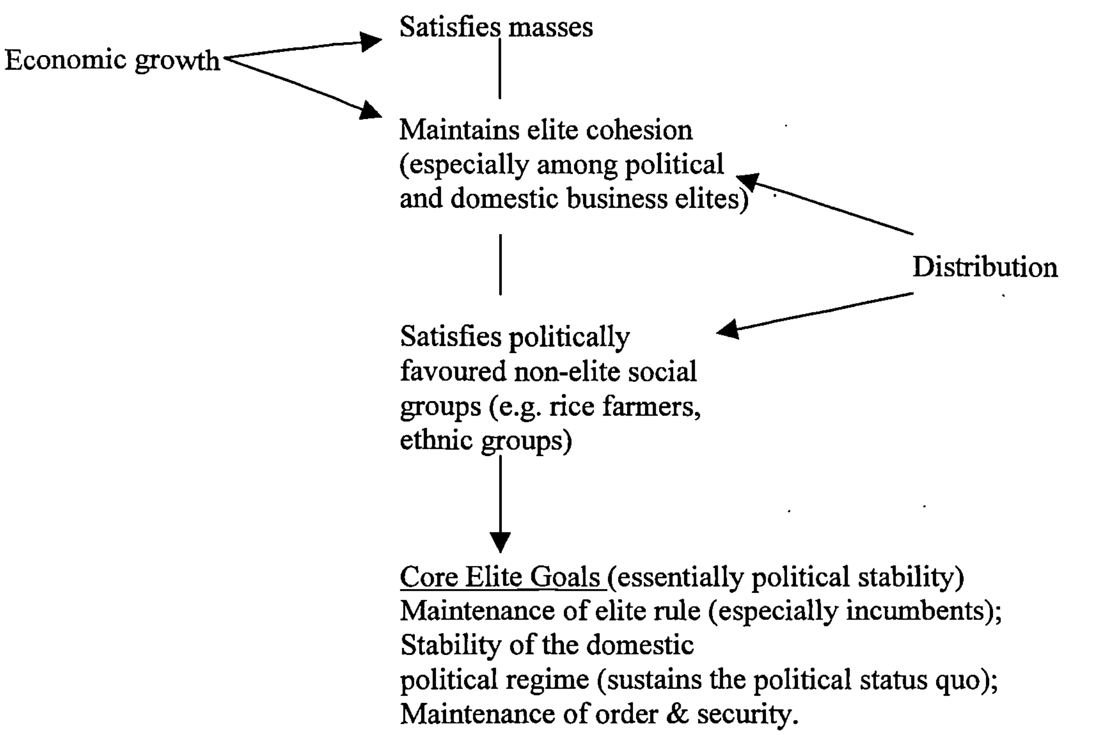
[44] Economic rents are essentially the excess returns to factors of production that may be secured due to their scarcity. Governments often create artificial scarcity, through imposing import tariffs or allocating monopoly rights for instance.

[45] In the ASEAN countries, as in most developing countries, internal vulnerabilities are considered to be far more threatening to state structures and to the governing regime than are external, military challenges. See Ayoob (1995).

growth (Bhagwati, 1982). Such policies can potentially also hinder the domestic operations of foreign firms, thus weakening growth prospects by precluding these significant agents of growth. Growth need not, however, be disrupted if the extent of distribution is limited, either to particular sectors or in terms of time.[46] Moreover, growth often enables distribution to take place with fewer costs than under conditions of generalised economic decline. On the other hand, when efficiency or growth considerations are paramount, governments' distributive role may be affected. The role of economic growth and distribution in elite governance systems is depicted in Figure 1.1.

Figure 1.1
The Role of Growth and Distribution in Elite Governance Political Systems



[46] Jayasuriya (2001) argues that distributive policies and programmes that were predominant in the non-tradeable sectors in many Southeast Asian countries were sustained by high economic growth derived in the more market-oriented and internationally efficient tradeable sectors, often dominated by foreign firms. FDI-centred growth in export-oriented sectors enabled governments to maintain

6. Conclusion: The Dissertation's Main Propositions

A modified economic realist perspective offers substantial analytical purchase over liberal perspectives in explaining regionalism as an outcome of globalisation. Its value as a theoretical tool comes from its recognition that states continue to matter, and more importantly, that the governments of these states can, and often do consciously manipulate inter-state relations to try and alter international political economy structures in line with domestic interests. Regionalism can be interpreted as one such instrument for states to pool their resources in order to influence the international political economy. This approach thus shares the basic statist ideas of the regional governance approach to globalisation outlined in Hout (1999: 25-28). Much of the international politics of Southeast Asia continues to operate along statist lines. As such, the economic realist perspective combined with a suitable model of domestic politics – the elite governance model in the case of ASEAN – generates rich insights into the globalisation-regionalism relationship.

Rather than the two basic models found in the literature, the combined economic realist-domestic politics framework allowed a third theoretical model – developmental regionalism – to be advanced, which also draws on insights from strategic trade theory in economics rather than liberal/neoclassical economics (Table 1.1). Specifically for ASEAN, the elite governance model of domestic politics reveals the basic tensions between growth and distribution in the core ASEAN countries, and how these tensions relate to foreign and domestic capital in the domestic political economy. Most importantly, it shows why in particular settings where domestic capital is usually not as well developed as foreign capital but often plays a crucial political role, including distribution,

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distributive programmes to favoured domestic firms, many with political connections that were found in protected and less efficient non-tradeable sectors like services.

governments may well respond to globalisation in ways that attempt to preserve and nurture domestic capital. In the model of developmental regionalism advanced in the chapter, its proponents, although not resisting globalisation, nevertheless do not fully accept the notion of the hegemony of foreign/global corporate giants that is part of the globalisation phenomenon, and attempt to support the development of domestic capital through regionalism.

Moreover, economic realist insights allowed a distinction to be made within the dominant open regionalist model to reveal two variants, *neoliberal regionalism and the FDI model of* regionalism, the latter more likely to reflect embedded neoliberalism (Table 1.1). The distinction is not a trivial one. The discussion indicated how the two variants of open regionalism display distinct features and more importantly, different trajectories. The significance of this distinction will become clear in the concluding chapter, which discusses the future trajectory of Southeast Asian economic regionalism.

Table 1.1

Theoretical Models of the Globalisation-Regionalism Relationship

Theoretical Models (Ideal-Types)	**Relationship to Globalisation**	**Key Driving Force**	**Key Features**	**Relationship to Foreign and Domestic Capital**
Neoliberal Regionalism [Variant of open regionalism]	Engages with globalisation	Concern with efficiency	No new barriers to non-members imposed; Full deregulatory agenda contemplated; Also associated with agenda to reduce government's role in all aspects of economic activity; Hence the neoliberal credentials.	Does not distinguish between foreign and domestic capital
FDI Model [Variant of open regionalism]	Engages with globalisation	Concern with attracting FDI, which is a crucial source of growth; Efficiency may be either a primary or secondary concern.	No new barriers to non-members imposed; Deregulation agenda could be extensive or limited; Ambivalent with regard to government's role in the economy; More likely to be an instance of embedded neoliberal regionalism [a]	Foreign capital (FDI) privileged
Resistance Model	Resists globalisation	Concern with political legitimacy	Seeks insulation from global market forces; Dominant agenda is social/distributive.	Other social groups, apart from capital privileged, notably labour
Developmental Regionalism	Essentially engages with globalisation, although it also involves limited and temporary resistance to it	Concern with distribution initially, with growth a long-run concern	Employs temporary protection of, or temporary privileges for, domestic capital; Distribution is thus directed towards domestic capital.	Domestic capital privileged

[a] The notion of an 'embedded neoliberal' regional project is borrowed from van Apeldoorn (2000: 241). Also see footnote 29.

The dissertation's central propositions

The central hypothesis in the dissertation is that the type of regionalism that emerges as a result of globalisation is mediated by domestic political economy dynamics centred on the relationship between growth/efficiency and distribution, even in the case of regionalism projects that seek engagement with globalisation. Based on the discussion in this chapter, the following specific propositions with regard to AFTA that derive from the central hypothesis are advanced, and will be developed in the rest of the dissertation.

The first proposition is that AFTA is likely to encompass the features of *both* open regionalism as well as developmental regionalism due to the political significance of *both* foreign and domestic capital. Although both projects are the outcome of globalisation, and driven by a concern with economic growth and with engaging with globalisation, domestic priorities centred on nurturing domestic capital infuse the growth imperative in the case of developmental regionalism. This is likely to result in departures from open regionalism in the design of regional cooperation. Chapters 3 and 4 examine these arguments in detail.

The second proposition is that the distributive imperative may well be so overwhelming despite initial commitments to cooperate driven by the growth dynamic that governments opt to shield particular elements of domestic business from the liberalisation required under both open regionalism and developmental regionalism. Disputes among regional members are likely as governments renege on their original commitments as they attempt to balance growth and distributive concerns. Chapter 5 elaborates on this proposition.

Leading from this, the third proposition is that implementation becomes a political process rather than a technical one of complying with commitments already made earlier. This requires some form of regional mechanism to address the tension between growth and distribution and to enable cooperation to be sustained and advanced rather than abandoned. To develop this third proposition further, additional theoretical insights are required, which are drawn from the IR literature on compliance bargaining and international institutions. The latter is discussed in detail in Chapter 6, which also fleshes out the third proposition.

CHAPTER 2

THE ASEAN FREE TRADE AREA (AFTA), 1991 – 2000:

The Unfolding of a Regional Economic Cooperation Project

1. Introduction

Before proceeding to develop the dissertation's three main propositions that were outlined in the previous chapter, it is necessary to have an idea of developments in AFTA during the period under study. This exercise, the subject of the present chapter, is aimed at providing the empirical background for the analysis in the rest of the dissertation. More importantly, it highlights the major trends in AFTA as well as identifies puzzling aspects of the regional project, issues that were first raised in the introductory chapter and which the remaining chapters attempt to interpret, and explain. This chapter, thus, describes in detail the unfolding of the AFTA project between 1991 when the initial decision to establish a free trade area in ASEAN was made and 2000. It describes the commitments that were made in AFTA by the core member governments in all three component programmes – the CEPT, AFAS, and the AIA – as well as notes how well these commitments were complied with, or at least the prospects for their implementation. This had yet to be done for AFTA at the time of writing.

The discussion in Section 2 reveals that contrary to earlier predictions of its failure, AFTA has made substantial advances as its pace was accelerated and its scope widened, particularly to include potentially contentious issue areas like unprocessed agricultural products, services, and investment. Commitments to jointly reduce tariffs and non-tariff barriers were forthcoming throughout the decade, while consultations were held to develop commitments in services and investment liberalisation. Notwithstanding these achievements, Section 3 discloses that implementation of certain commitments, especially in the new issue areas presented problems. Section 3 also briefly introduces the three major disputes in AFTA that emerged among the ASEAN governments during the course of the decade – in liberalising trade in agriculture, automobiles and petrochemicals.

2. AFTA: Ambitious Undertakings/Commitments

The AFTA project can be divided into three phases for analytical purposes (Table 2.1). Phase 1 from 1991 through 1995 may be termed the initial consolidation stage. During this period, the decision to form AFTA was made and its initial agenda worked out. Some member governments soon went back on some of their AFTA commitments as a result of recent domestic political changes and growing domestic business opposition to AFTA. Nevertheless, by the end of 1995, the ASEAN governments had reaffirmed the free trade goals of AFTA. In addition, they also agreed to hasten its implementation and expand its scope by committing unprocessed agricultural products, services, and investment to joint liberalisation.

Phase 2, the expansion phase of AFTA covers the years 1996 and 1997, and is the period when detailed negotiations on agriculture, services and investment liberalisation, as well as on industrial cooperation got underway. Phase 3 from 1998 through 2000 represents the financial crisis and post-crisis period. This was not only a time when existing initiatives were consolidated, more importantly, a number of new initiatives were undertaken in response to the crisis. Nevertheless, this was also a time when a number of ASEAN governments attempted to delay on their AFTA commitments, arguing that domestic industries already badly affected by the regional financial crisis could suffer further if subject to AFTA liberalisation as committed to previously. The following sub-sections provide a more detailed description of the evolution of AFTA through these three phases.

Table 2.1
The Three Phases of the AFTA Project

PHASE 1 (1991-95) **Initial Consolidation Phase**	**PHASE 2 (1996-97)** **Expansion Phase**	**PHASE 3 (1998-2000)** **Financial Crisis & Post-Crisis Phase**
Free trade area by 2008 Tariffs on manufactured products targeted at 0-5%; Excludes unprocessed agricultural products and services; Staggered implementation start date allowed; New members finish later. Acceleration of AFTA: new deadline is 2003 0-5% tariff target; Implementation date fixed at 1st January 1994; Includes detailed programme for non-tariff barriers and trade facilitation; New members finish later. Formal decision to expand AFTA to include new issue areas (December 1995) Unprocessed agricultural products; Services; Industrial cooperation; Investment; Intellectual property rights.	First round of services negotiations begun Negotiations in seven priority sectors; 1st Package: December 1997; 2nd Package: December 1998. ASEAN Industrial Cooperation (AICO) scheme formally launched (1996) Requires minimum 30% national equity; Minimum of 2 firms from 2 ASEAN countries required to participate; Firms must be involved in joint industrial production or the pooling/sharing of raw and intermediate materials. The ASEAN Investment Area (AIA) initiative Initial negotiations launched. Unprocessed agricultural products Negotiations to iron out differences among members and to develop suitable modalities for liberalisation; Dispute Settlement Mechanism adopted (1996)	New flexible deadline of 2002 (0-5% tariff target) (1998 decision) Formal deadline remains 2003. Zero tariff AFTA (1999 decision) By 2010 (initially 2015) for original members. AIA Framework Agreement signed (October 1998) National treatment and market access initially by 2010 for ASEAN investors and 2020 for non-ASEAN investors; Deadlines revised in March 1999: AIA to be realised in 2003 for ASEAN investors in manufacturing and 2010 in other selected sectors; For non-ASEAN investors: 2020. Protocol adopted on liberalising sensitive agricultural products (1999) Liberalisation to begin between 2001& 2003/ 2005; Completion date: 2010. Second round of services negotiations launched All service sectors; Negotiations over 1999-2001; Negotiations targeting all four modes of service delivery. Other framework agreements adopted to support AFTA: On goods in transit (December 1998); Mutual recognition arrangements (December 1998); On E-commerce (November 2000). Short-term Incentives to Enhance Investment Climate * Limited to applications received between 1-1-99 and 31-12-2000; 100% foreign equity and domestic market access offered in selected areas; Waiver of the 30% national equity requirement in AICO.

* Not directly a part of the AFTA project but, nevertheless, impinge on AFTA.

2.1 The Initial Consolidation Phase (1991-95)

In June 1991, the then Thai Prime Minister, Anand Panyarachun, publicly advocated the idea of an ASEAN free trade area. Anand had, in April 1991, initially broached the idea with the Singapore Prime Minister, Mr Goh Chok Thong, and then pressed the idea on his other ASEAN counterparts over the next few months (Stubbs, 2000: 304). The idea was then endorsed as an ASEAN project by the ASEAN foreign ministers in July 1991 and later at the 23rd ASEAN Economic Ministers' meeting (23rd AEM)[1] in October of the same year.

The ministers at the AEM agreed that all member countries should subscribe to the establishment of AFTA simultaneously so that within 15 years a single regional market where internal tariffs were between 0-5 per cent would become a reality. The instrument that would operationalise AFTA was the Common Effective Preferential Tariff (CEPT). The 23rd AEM agreed that a Framework Agreement should be drafted under which specific areas of cooperation could eventually be negotiated. Ministers then tasked the Senior Economic Officials Meeting (SEOM) of ASEAN to work out the form and substance of the Framework Agreement that was scheduled to be signed at the forthcoming Fourth ASEAN Summit in Singapore in January 1992.[2]

In each country, discussions about AFTA were confined to a small group as leaders, ministers and officials tried to gauge the minimum level of commitments they could credibly make (Stubbs, 2000: 304). By the time of the fourth summit, senior officials from the economics ministries in the various ASEAN governments had together worked out

[1] The annual series of ASEAN Economic Ministers Meetings (AEM) began in 1969 when member governments first decided to explore the possibility of economic cooperation.
[2] The SEOM is a meeting of senior civil servants, usually at the level of permanent secretaries or their equivalent from the economic or related ministries from each ASEAN member country.

preliminary details of the two agreements that would launch AFTA and provide its operational workings. The official summit declaration, namely the *Singapore Declaration* set out the broad areas for ASEAN cooperation in the security, political and economic fields (ASEAN, 1992a). The *Framework Agreement on Enhancing Economic Cooperation* (ASEAN, 1992b) and the *Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area* (the CEPT Agreement) (ASEAN, 1992c) focused specifically on the principles and procedures for establishing AFTA within 15 years. These two agreements collectively formed what is regarded in this dissertation as the foundational AFTA agreements.

Initial details are sketchy

Under the AFTA agreements, tariffs on intra-ASEAN trade in manufactured goods including capital goods and processed agricultural products were due to be lowered to between 0-5 per cent within 15 years starting from January 1993. Raw materials, unprocessed agricultural products, and services were not covered in the original agreement. An ASEAN content of at least 40 per cent was required for products to qualify for preferential tariffs.[3] While Anand's original proposal had suggested a 10-year time frame for the realisation of AFTA, which Singapore and Malaysia supported, the time frame was extended to 15 years to take account of objections from Indonesia and the Philippines. The Indonesian and Philippine governments had been concerned that some of their domestic industries were too weak and had requested for special and differential treatment under AFTA.[4]

[3] The local content rules are liberal in that once a component reaches the 40 per cent local content target it is automatically considered to be 100 per cent locally produced for purposes of cumulation. See ASEAN Secretariat (1993: 42) and Ravenhill (1995: 859, fn. 17).
[4] *AWSJ*, 'ASEAN nations endorse plans for free trade zone', 9 October 1991.

The CEPT became the primary mechanism to implement AFTA although the original CEPT Agreement containing ten Articles provided only general guidelines on tariff reduction schedules (ASEAN, 1992c). Article 2 specified that products to be included in the CEPT were to be identified on a sectoral or product group basis, that is, at the HS (Harmonised System) 6-digit level. Exclusions at the HS 8 or 9 digit level for specific products were, however, permitted under the CEPT for those member countries temporarily wishing to exclude particular products from AFTA disciplines. No limits were placed on the number of products that might be excluded in this manner. There were plans to review products initially excluded after eight years, although no further details were provided on what would happen after the review.

Article 4 of the CEPT agreement outlined the tariff reduction schedule. For products with tariff rates above 20 per cent, ASEAN members were called to initially harmonise internal tariffs to 20 per cent or less within a five to eight year time frame beginning from 1 January 1993, with each country working out its own schedule of reduction. Although the CEPT Agreement advised members to adopt an annual rate of reduction, this was ultimately left to individual members who could, theoretically, undertake the bulk of the reductions in the final year. Subsequent tariff reductions from 20 per cent to 0-5 per cent were to be undertaken within a seven-year time frame, making a total 15-year implementation period. In this case, a minimum annual rate of reduction of 5 per cent was specified in the CEPT Agreement. The tariff reduction schedule for products whose prevailing tariff rates were already below 20 per cent on 1 January 1993 was to be determined and announced by the governments concerned. These schedules were, moreover, not designated as binding, but as indicative only. There was clearly enormous flexibility in the CEPT programme, including a very long implementation phase, especially for products whose initial tariffs were below 20 per cent.

Despite Article 4, the initial details on tariff reductions were somewhat hazy, while few clear guidelines were provided for the elimination of quantitative restrictions and non-tariff barriers (NTBs).[5] It was only during the course of 1992 that additional implementation details were worked out by economic ministers. The 24th AEM in October 1992 reiterated the 1 January 1993 starting date for AFTA. Other operational details of the CEPT scheme were finalised at the 3rd AFTA Council[6] meeting in December of that year.[7] These details were contained in three documents published by the ASEAN Secretariat, namely the *Operational Procedures for CEPT*, *Rules of Origin for CEPT*, and *Interpretative Notes to the Agreement on the CEPT Scheme for AFTA* (ASEAN Secretariat, 1993). The most important of these details were the fast track schedule for 15 product groups, the normal track schedule for remaining manufactured goods, as well as the nature of exclusions allowed (Table 2.2). These schedules were, however, deemed to be indicative only, with member governments allowed a faster or slower rate of tariff reduction provided the targeted tariff rates were reached by the stipulated end dates (ASEAN Secretariat, 1993: 4-5).

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[5] See Article 5 (A) of the CEPT Agreement (ASEAN, 1992c).
[6] Article 7 of the CEPT Agreement provides for the establishment of the AFTA Council, an inter-governmental ministerial council comprising one nominee from each ASEAN member country. The Council is tasked with supervising, coordinating and reviewing the implementation of the CEPT Agreement. It also handles dispute resolution. Although the AFTA Council and the AEM are distinct organisational entities, the same minister often participates at both Council and Ministerial meetings.
[7] See Press Statement, *Third AFTA Council Meeting*, Indonesia, 11 December 1992.

Table 2.2
Implementation Details of the 1992 AFTA Agreement

AFTA Agreement (1992) (starting date 1/1/93 or 1/1/96)[a]	Target Date for Achieving 0-5% Tariff Rate		Exclusions Allowed
	Fast Track[b]	Normal Track	
Initial Tariff Rates Above 20%	1/1/2003 (within 10 years)	Initially to 20% by 1/1/2001 or 1/1/98 (within 5-8 years); Then to 0-5% by 1/1/2008 (within 7-10 years)	General Exemptions[c] Temporary Exclusions[d] Permanent exemptions possible[e]
Initial Tariff Rates At or below 20%	1/1/2000 (within 7 years)	1/1/2003 (within 10 years)	

[a] The starting date could be later than 1/1/1993 provided target dates were reached on schedule. A three-year grace period, until 1996, was given.
[b] Covers 15 product items, namely vegetable oils; chemicals; fertiliser; rubber products; pulp and paper; wooden and rattan furniture; gems and jewellery products; cement; pharmaceuticals; plastics; leather products; textiles; ceramics and glass products; copper cathodes; electronics.
[c] Allowed to protect national security; public morals; human, animal or plant life/ health; and to preserve articles of artistic, historic or archaeological value.
[d] Includes products that governments feel are not ready for tariff liberalisation. Subject to review at the end of eight years.
[e] Permanent exemptions allowed, essentially for unprocessed agricultural products.

Source: Table 1 compiled from information in ASEAN Secretariat (1993: 3-4)

<u>Substantial flexibility is allowed</u>

Despite firming up details in the CEPT during the course of 1992, the AFTA project remained a very flexible programme of trade liberalisation. For instance, while temporary exclusions were allowed subject to a review after eight years, permanent exemptions were also possible. The idea behind the rather long eight-year period of temporary protection was to allow individual member governments sufficient time to prepare their respective domestic industries for AFTA tariff reductions.[8] There was, however, nothing to prevent member governments from continuing to exclude products after the eight-year temporary exclusion period, for instance by transferring products to the permanent exemption list

[8] See *AWSJ*, 'ASEAN officials agree on details of trade area', 14 December 1992.

(also called the sensitive list). This extremely flexible arrangement added to the uncertainty inherent in the AFTA project.

Although tariff reductions were scheduled to begin on 1 January 1993, member countries were later allowed a grace period until January 1995 to begin their respective CEPT liberalisation programmes. The staggered approach had been adopted to overcome plans by both Thailand and Indonesia to opt out of AFTA altogether for several of the 15 categories of products designated for fast track tariff cuts.[9] These two countries thus planned to begin accelerated tariff reductions only from 1995, and to delay beginning normal track tariff reductions until between 1996 and 1999 (Table 2.3).[10] On the other hand, Malaysia and Singapore pledged to begin tariff reductions as scheduled on 1 January 1993. The Philippines was already committed to a unilateral programme of tariff reductions under Executive Order 470 that was to end in 1995, after which it would continue to reduce tariffs under the CEPT programme.

Table 2.3

AFTA Tariff Reduction Start Dates (adopted December 1992)

	Fast Track		Normal Track	
	Initial tariffs above 20%	Initial tariffs at or below 20%	Initial tariffs above 20%	Initial tariffs at or below 20%
Brunei	NA[a]	1995	1994	1996
Indonesia	1995	1995	1998	1996
Malaysia	1993	1993	1993	1993
Philippines	Unilateral[b]	Unilateral[b]	Unilateral[b]	Unilateral[b]
Singapore	1993	1993	NA[a]	1993
Thailand	1995	1995	1998	1999

[a] Not applicable, since there were no tariffs above 20%.
[b] Until 1995.

Source: Table compiled from information in ASEAN Secretariat (1993: 17-20)

[9] See *AWSJ*, 'ASEAN moves closer to paring group tariffs', 26 October 1992.
[10] Thailand, however, reduced tariffs under the CEPT scheme on selected items in February 1993. See *Business Times*, 'Anand, the white knight of Thai politics', 8 March 1993.

Attempting to kick-start AFTA

Despite the firming up of some details and the allowances made to ensure the cooperation of all AFTA founding members, the AFTA project ground to a halt in 1993. Malaysia and Singapore were unhappy with the staggered approach since that placed their domestic industries at a disadvantage.[11] Malaysia, in fact, considered delaying its AFTA tariff cuts until 1995 when all ASEAN countries were obliged to begin CEPT tariff reductions to ensure that domestic industries were not at an unfair disadvantage in AFTA.[12] The new Thai government of Prime Minister Chuan Leekpai elected in mid-1992 called for a "transition period" for AFTA, as Thai businesses began pressing the newly elected government to delay its AFTA commitments.[13] In Indonesia too, the commitment to AFTA began waning as ministers less committed to trade liberalisation were selected to the new cabinet announced by President Suharto in mid-March 1993 while protected businesses, especially the state-enterprise sector, also began pressing policy-makers to rethink AFTA.[14]

Nevertheless, by October 1993, senior officials in ASEAN had worked out a proposal to re-launch AFTA, with five of the six ASEAN countries now pledging to begin AFTA tariff cuts by 1 January 1994.[15] Thus, the staggered implementation programme was replaced in favour of a common start date. At this time, member governments also agreed to submit 41,147 tariff lines to AFTA disciplines through a revised CEPT package issued in 1994, accounting for 88.3 per cent of their total tariff lines (ASEAN Secretariat, 1993: 24).

[11] *Business Times,* 'Industries hit by AFTA scheme', 10 April 1993.
[12] See *New Straits Times (NST)* 'KL may consider delaying tariff cuts', 16 July 1993.
[13] *NST* 'ASEAN needs transitional period', 26 March 1993.
[14] *AWSJ*, 'ASEAN moves closer to paring group tariffs', 26 October 1992.
[15] For administrative reasons, Brunei was to begin CEPT tariff cuts in June 1994. See the ASEAN *Annual Report 1993-94.*

Other serious problems remained despite the advances made in 1993 to kick-start the project. These included the lack of clear guidelines on how NTBs were to be reduced. NTBs were potentially a considerable stumbling block to forming a regional free trade area in ASEAN (Chia, 1998: 218-19; Ravenhill, 1995: 859). The most common NTBs in ASEAN were customs surcharges, technical measures, and domestic monopoly arrangements (Table 2.4). In addition, non-harmonised customs classification and valuations systems also created opportunities for discrimination against imports (Ravenhill, 1995: 860; Chia, 1998: 226). The institutional arrangements for the AFTA project were also inadequate in rule interpretation and dispute settlement, which, given the lack of detail in the foundational AFTA agreements, were particularly necessary.[16] The preference in ASEAN for political rather than administrative or juridical arrangements for dispute settlement and problem resolution was seen as placing a substantial burden on ministerial agendas in AFTA, with the possibility that AFTA could become stalled in the process (Ravenhill, 1995: 861).

Table 2.4

Most Prevalent Non-Tariff Barriers in ASEAN by Number of Tariff Lines

Non-Tariff Barriers (NTBs)[a]	Number of tariff lines affected
Customs surcharges	2,683
Additional charges	126
Single channel for imports (monopolistic practice)	65
State-trading administration (monopolistic practice)	10
Technical standards (technical measure)	568
Product characteristic requirements (technical measure)	407
Marketing requirements (technical measure)	3
Technical regulations (technical measure)	3

[a] Definitions of the various NTBs are found in ASEAN Secretariat (1995: 10-15)

Source: ASEAN Secretariat (1995: 15)

[16] The foundational AFTA agreements of 1992 took only about 16 pages. The NAFTA Agreement, in contrast, came up to more than 1,000 pages (Ravenhill, 1995: 859).

The AFTA project nevertheless advances

In 1994 and 1995, the AFTA programme was substantially modified at the 5th to the 8th AFTA Council meetings and the 26th and 27th AEM meetings. The ASEAN leaders formally accepted these amendments at their fifth summit in Bangkok in December 1995 (ASEAN, 1995a, b & c). Five improvements to AFTA were adopted.

First, the 0-5 per cent CEPT tariff target for manufactured goods was to be reached within ten years instead of the original 15 years, with concomitant changes to the fast and normal track schedules (Table 2.5).[17] Member governments also agreed to begin implementing fast track tariff reductions from 1 January 1996.[18] Moreover, a total of 44,752 tariff lines were included in the revised 1996 CEPT package, representing over 90 per cent of all tariff lines in ASEAN.[19]

Table 2.5
Revised (1994/95) Implementation Details of the AFTA Agreement

Revised (1994/95) AFTA Agreement (starting date 1/1/94)	Target Date for Achieving 0-5% Tariff Rate		Exclusions Allowed
	Fast Track	Normal Track	
Initial Tariff Rates above 20%	1/1/2000 (within 7 years)	Initially to 20% by 1/1/98 (within 5 years); Then to 0-5% by 1/1/2003 (within 5 years)	General Exemptions[a] Temporary Exclusions[b] Permanent Exemptions[c]
Initial Tariff Rates at or below 20%	1/1/1998 (within 5 years)	1/1/2000 (within 7 years)	

[a] Unchanged. See Table 2.1 for definition.
[b] To be eliminated in 2000. Also, 20 per cent of items in this list to be transferred automatically to CEPT inclusion list annually over five years beginning January 1996 and ending January 2000.
[c] A few unprocessed agricultural products only. Also termed the 'sensitive list'.

Source: ASEAN Secretariat (1995: 1-2)

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[17] See Joint Press Statement, *Fifth AFTA Council Meeting*, Thailand, 21 September 1994.
[18] See Joint Press Statement, *Sixth AFTA Council Meeting*, Thailand, 27 April 1995.
[19] See Joint Press Statement, *Seventh AFTA Council Meeting*, Brunei Darussalam, 6 September 1995 and ASEAN *Annual Report 1995-96*.

Second, AFTA's scope was expanded as unprocessed agricultural products were brought under the CEPT mechanism though with a number of as yet undecided exclusions. This was a notable advance in AFTA given that all the ASEAN countries except Singapore and Brunei had sizeable agricultural communities that member governments usually tried to protect from competing imports. A working group was set up to explore ways to ensure that the list of excluded agricultural products was kept as short as possible and to find ways to include into the CEPT framework those agricultural products still excluded.

Third, procedures governing the Temporary Exclusion List were tightened. The revised rules stipulated that member governments would have to transfer on an annual basis 20 per cent of the current 3,141 items currently in the Temporary Exclusion List to the CEPT Inclusion List between 1996 and 2000. The first instalment of 682 products was transferred to the Inclusion List on 1 January 1996.[20] Where previously the Temporary Exclusion List was only to be reviewed in 2000, the amendments meant that the list would effectively cease to exist after five years, with the final transfer to the Inclusion List made on 1 January 2000.

Fourth, senior officials from member countries developed programmes for trade facilitation and reduction of NTBs (ASEAN Secretariat, 1995: 9-25). The former included measures to harmonise tariff nomenclature, customs valuation systems and customs procedures, as well as the introduction of a green-lane system to expedite customs clearance of CEPT products. Work on the elimination of NTBs included measures to align product standards to international standards and to facilitate mutual recognition of product testing and standards. Some aspects of trade facilitation, notably harmonising customs nomenclature and valuation systems among the ASEAN countries were also expected to contribute to reducing NTBs.

Finally, apart from including unprocessed agricultural products, AFTA's scope was further expanded as new issue areas like services, investment and industrial production were brought under its ambit for regional cooperation, although further details were left for the future to be worked out. These were collectively known as the 'AFTA-Plus' programmes and they involved coordinating non-border arrangements in these new issue areas to complement the reduction of tariffs and non-tariff barriers to form a single regional market (ASEAN Secretariat 1998a: vii). In addition, member governments agreed to develop a regional mechanism to protect intellectual property (ASEAN, 1995e). The ASEAN leaders also pledged in their Summit Declaration to develop a mechanism for dispute settlement (ASEAN, 1995a).

2.2 Expansion Phase (1996-97)

As noted above, the formal commitment to expand AFTA's scope was made at the Fifth ASEAN Summit in Bangkok in December 1995. Details on how cooperation was to be achieved in services, investment and industrial production were worked out by the senior officials of ASEAN through a series of consultations throughout 1996 and 1997, some of which are ongoing at the time of writing. In addition, negotiations over the specifics of agricultural trade liberalisation continued during this period to overcome the impasse that had emerged in 1995 as a number of countries retracted earlier tariff liberalisation offers. A formal *Protocol on Dispute Settlement Mechanism* (DSM) was also adopted in November 1996 (ASEAN, 1996b).

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[20] Joint Press Statement, *Seventh AFTA Council Meeting*, Brunei Darussalam, 6 September 1995.

Cooperation in services

The *ASEAN Framework Agreement on Services* (AFAS) signed in December 1995 aimed at liberalising trade in services within ASEAN, while its goal was to eventually establish an ASEAN free trade area in services by 2020 (ASEAN, 1995d; ASEAN Secretariat, 1995: 31). The AFAS committed member governments to further negotiations to liberalise seven key service industries, namely finance and banking, tourism, telecommunications, shipping, air transport, construction and business services (ASEAN, 1995d). More specifically, member governments were committed to eliminating substantially all existing discriminatory measures and market access limitations among ASEAN member countries within a reasonable timeframe that was, however, not clearly specified. Article IV of the AFAS pledged member governments to make commitments that went beyond their offers in the General Agreement on Trade in Services (GATS). Also, Article VI explicitly denied the benefits of the Agreement to service providers from non-ASEAN member countries unless these service providers had established substantive operations in an ASEAN member country. Thus far, two rounds of negotiations to obtain specific commitments have been conducted. The first round (1996-1998) produced two packages of broad commitments while the second (1999-2001) is ongoing.

The ASEAN Industrial Cooperation Scheme (AICO)

The ASEAN Industrial Cooperation (AICO) Scheme was launched in April 1996 when economic ministers signed the *Basic Agreement on AICO* to promote joint industrial production in ASEAN (ASEAN, 1996a). Under the AICO scheme, participating companies must be involved in some form of joint industrial production either through producing component parts for the other company or through the sharing of raw and/or intermediate resources. Products of an AICO arrangement were set to immediately enjoy tariff rates of 0-5 per cent among the two countries concerned without having to wait for either the fast or normal track programmes under the CEPT. A 30 per cent national equity requirement was imposed for companies wishing to be considered for AICO privileges, although a waiver provision was later included to allow firms already operating in the region but unable to meet the national equity criterion to participate in AICO.[21]

The scheme, thus, allowed firms the right to enjoy the benefits of a regional free trade area for particular approved products well before the 2003 date for the completion of the CEPT.[22] The AICO replaced two previous programmes of industrial cooperation in ASEAN, namely the ASEAN Industrial Joint Ventures (AIJV) and the Brand-to-Brand Complementation Scheme (BBC).[23] Like the AICO, both these earlier schemes had similarly attempted to facilitate joint industrial production within ASEAN, although the BBC was specifically targeted at the production of automobile parts and components. The AICO scheme, initially limited to manufacturing industries, was far more flexible than the schemes it replaced, particularly the AIJV. For instance, the AICO scheme required the participation at the minimum of only two member countries agreeing to grant the specified tariff privileges to participating companies, with at least one company to be located in each participating country. Previously, at least four firms from four member countries were required to participate in the AIJV.[24]

<u>The ASEAN Investment Area (AIA) – negotiations underway during 1996 and 1997</u>

At the December 1995 Bangkok Summit, the ASEAN leaders also agreed to establish an ASEAN Investment Area (AIA), a long-term project that would seek to gradually eliminate national investment restrictions in favour of more liberal rules for investors.

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[21] See ASEAN *Annual Report 1996-97.*
[22] Unless specifically mentioned, the completion of the CEPT refers to the time when intra-ASEAN tariffs reach the 0-5 per cent range, and not when they are set to reach zero.
[23] See ASEAN *Annual Report 1996-97.*

Throughout 1996, 1997 and in the first nine months of 1998, senior officials worked out the details of the programme. By October 1998, a *Framework Agreement on the ASEAN Investment Area* was ready to be signed by ASEAN economic ministers (ASEAN, 1998d). The details of the AIA programme are discussed in the following sub-section.

2.3 The Financial Crisis and Post-Crisis Phase (1998-2000)

Just as the core ASEAN member governments agreed to hasten the implementation of AFTA and expand its scope in 1994-95, a further set of advances to AFTA commitments occurred after the Asian financial crisis began in July 1997. Decisions were made to further accelerate the completion of the free trade area and expand its scope while the AIA programme was also improved. Programmes begun earlier were continued and consolidated, most notably the launching of a second round of services negotiations in 1999 that was due to end in 2001. In addition, a number of short-term liberalisation measures to enhance the investment climate in ASEAN were adopted. Although these were not formally part of AFTA, they are best regarded as supplementing the AFTA project. These new initiatives were outlined in detail in a *Statement on Bold Measures* adopted by member governments at the Sixth ASEAN Summit in Hanoi in December 1998 (ASEAN, 1998c).

Advancing the CEPT

The ASEAN leaders had, at their Second Informal Summit in Kuala Lumpur in December 1997, recommended the acceleration of both the CEPT and the AIA although they left details to their ministers to work out.[25] In October 1998, the 12th AFTA Council agreed to accelerate the implementation of AFTA by maximising the number of tariff lines to be

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[24] Tongzon (1998: 58-65) discusses the AIJV and the BBC in some detail.

reduced to zero per cent by 2003, rather than the 0-5 per cent ending tariff range. At this time, individual governments also made significant offers to accelerate AFTA, especially by submitting previously excluded products for liberalisation.[26] This was significant, since there had been some previous discussion between the ASEAN member countries in 1998 over whether to delay CEPT implementation because of the regional financial crisis.[27] By the time of their Sixth Summit, the leaders of ASEAN decided that member countries should bring forward to 2002 the date by which tariffs in the core ASEAN countries would reach the 0-5 per cent target. The official completion date remained 2003, however (ASEAN, 1998c).

A year later in September 1999, the 13th AFTA Council meeting decided to set the target date for complete elimination of all tariffs at 2015 for the original six signatories.[28] Later, at their Third Informal Summit in Manila in November 1999, the ASEAN leaders committed themselves to eliminating all tariffs and import duties by 2010, five years earlier than the 2015 deadline initially agreed to by their economic ministers only two months previously.[29]

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[25] See Press Statement, *Second ASEAN Informal Meeting of Heads of State/Government of the Member States of ASEAN*, Kuala Lumpur, 15 December 1997.
[26] Joint Press Statement, *Twelfth AFTA Council Meeting*, 6 October 1998, Manila.
[27] See *Bangkok Post*, 'Tariff reductions may be delayed', 26 September 1998; and *Bangkok Post*, 'AFTA tariff cut delays likely if neighbours can't agree', 19 May 1999. Nevertheless, Thailand, Malaysia and the Philippines temporarily raised import tariffs and introduced other import measures on selected items in 1997 and 1998 as a way of dealing with the 1997-98 Asian financial crisis. See Shimizu (2000: 83) for details. Also see *Jakarta Post*, 9 February 1999.
[28] Joint Press Statement, *Thirteenth Meeting of the AFTA Council*, 29 September 1999, Singapore. The target date for new members was set at 2018.
[29] The deadline for new members was also advanced from 2018 to 2015 although some sensitive products would be allowed to follow the original 2018 deadline. See Chairman's Press Statement, *ASEAN Third Informal Summit*, 28 November 1999, Manila.

Advancing the ASEAN Investment Area

Under the terms of the 1998 AIA Agreement, member governments were committed to gradually eliminating investment barriers, according national treatment and allowing market access in the manufacturing sector initially to ASEAN investors by 2010 and to all foreign investors by 2020, beginning immediately where possible.[30] A 1999 amendment to the original AIA Agreement extended its coverage to include agriculture, forestry, fisheries, mining, as well as services incidental to all these sectors.[31] Member governments were, however, allowed to maintain investment restrictions until 2010 through a Temporary Exclusion List and indefinitely through a Sensitive List. The latter was only to be periodically reviewed with no firm timetable provided for its elimination. A decision later in 1999 stipulated that all temporary exclusions for ASEAN investors in manufacturing were to end by January 2003 instead of 2010, seven years earlier than initially envisaged.[32] All other sectors would be open to ASEAN investors by January 2010. No conditions were imposed on the Sensitive List.[33] Foreign investors would only realise these benefits in 2020.

Short-term measures to enhance the investment climate

Under the *Statement on Bold Measures* adopted at the Hanoi Summit in 1998, the ASEAN governments adopted a set of short-term measures to enhance the ASEAN investment climate (ASEAN, 1998c & 1998e). Each ASEAN government agreed to extend special privileges to qualified ASEAN and non-ASEAN investors in the manufacturing sector provided applications were received between January 1999 and December 2000. These

[30] For the purposes of the AIA Agreement, an ASEAN investor is deemed to be one who is accorded the status of a national or home country investor in each of the ASEAN countries.
[31] See Joint Press Statement, *Second Meeting of the AIA Council*, 29 September 1999, Singapore.
[32] See Chairman's Press Statement, *ASEAN Third Informal Summit,* 28 November 1999, Manila.
[33] These lists were compiled and published by the ASEAN secretariat in July 1999. See ASEAN Secretariat (1999b).

special incentives covered seven areas, among the most significant being 100 per cent foreign equity ownership in selected sectors and domestic market access (Table 2.6). In addition, the ASEAN governments also agreed to waive the 30 per cent national equity requirement for AICO projects, but only for projects approved during the 1999-2000 period. The waiver period was later extended by a year.

Table 2.6
Short-Term Equity and Domestic Market Access Offers Made in December 1998

COUNTRY	DOMESTIC MARKET ACCESS	EQUITY OFFERS
Brunei	n.a	100% foreign equity in high-tech & all export-oriented industries
Indonesia	For all industries except those in negative list and those operating in bonded zones.	100% foreign equity in wholesale/retail trade, all manufacturing, & in listed banks. After 15 years, some local equity ownership is necessary.
Malaysia	For all industries except those in negative list.	100% foreign equity in all manufacturing except seven specific activities/products. No export conditions.
Philippines	For all industries except those in negative list.	In the process of opening wholesale/retail trade to foreign ownership. Foreign companies allowed into domestic construction sector.
Singapore	For all industries except those in negative list.	Extension of 30% corporate income tax allowance to selected manufacturing and service industries.
Thailand	For all industries except those in negative list.	100% foreign equity in all manufacturing projects.

Source: ASEAN (1998c & 1998e)

3. AFTA: The Status of Implementation

Contrary to earlier predictions of its failure, the AFTA project was not only sustained, its pace was accelerated and its scope widened as the above discussion shows to include potentially contentious economic sectors like unprocessed agricultural products, services, and investment. Commitments to advance tariff liberalisation were forthcoming throughout the decade, while programmes were developed to address the problem of non-tariff barriers. Member governments engaged in extensive consultations and negotiations to advance commitments in services and investment cooperation. Yet, as the following discussion shows, the implementation record was mixed, with delays and setbacks experienced in agriculture, services and investment although the CEPT scheme was, by and large, on schedule.

3.1 Implementation of CEPT Tariff Liberalisation

Tariff liberalisation on goods trade within AFTA was essentially on schedule. Since its re-launch in 1994 after a disastrous start, or non-start, member governments have each year lowered tariffs on a range of products under the CEPT framework, with these reductions gazetted in national annual legal customs enactments.[34] By 1999, 98 per cent of total tariff lines in the core six ASEAN countries were included in the CEPT framework, the figure rising marginally to 98.3 per cent in 2001 (Tables 2.7 & 2.8). This was an improvement over the 1998 figure of 94 per cent and the 1996 figure of 90 per cent.[35]

At the beginning of 2000, tariffs on 90 per cent of products in the inclusion list, or 38,456 tariff lines, submitted by the core ASEAN countries had already fallen to 0-5 per cent, well ahead of the 2003 deadline for AFTA. This constitutes about 98 per cent of the total value of intra-ASEAN imports.[36] Moreover, current liberalisation schedules suggest that by 2003, about 40 per cent of total tariff lines will be at the 0 per cent tariff level, accounting for nearly 80 per cent of intra-ASEAN imports.[37]

[34] Since 1997, most of the ASEAN countries have enacted legislation covering the entire period of CEPT tariff reduction. Annual legal enactments continue, however, for products being moved from the temporary exclusion or sensitive lists to the inclusion list (ASEAN Secretariat, 1998a: 6).
[35] Calculated from data in the 1996 and 1998 CEPT packages. See Press Statement, *Eleventh AFTA Council Meeting*, Malaysia, 15 October 1997.
[36] Information was from the ASEAN Secretariat.
[37] Information was obtained from the ASEAN Secretariat.

Table 2.7

CEPT Implementation Package for 1999

	NUMBER OF TARIFF LINES				
COUNTRY	Inclusion List[a]	Temporary Exclusion List	General Exemption List	Sensitive List[b]	Total Tariff Lines (ASEAN-6)
Brunei	6,276	0	202	14	6,492
Indonesia	7,158	25	65	4	7,252
Malaysia	8,859	218	53	83	9,213
Philippines	5,571	35	27	62	5,695
Singapore	5,739	11	109	0	5,859
Thailand	9,103	0	0	7	9,110
ASEAN-6 Total	42,706 (98.0%)	289 (0.7%)	456 (1.1%)	170 (0.4%)	43,621 (100%)

[a] Includes both fast and normal track products
[b] Unprocessed agricultural products follow a delayed implementation schedule

Source: ASEAN Annual Report 1999-2000

Table 2.8

CEPT Implementation Package for 2001

	NUMBER OF TARIFF LINES				
COUNTRY	Inclusion List[a]	Temporary Exclusion List	General Exemption List	Sensitive List[b]	Total Tariff Lines (ASEAN-6)
Brunei	6,284	0	202	6	6,492
Indonesia	7,190	21	68	4	7,283
Malaysia	9,654	218	53	83	10,008
Philippines	5,622	6	16	50	5,694
Singapore	5,821	0	38	0	5,859
Thailand	9,104	0	0	7	9,111
ASEAN-6 Total	43,675 (98.3%)	245 (0.6%)	377 (0.9%)	150 (0.3%)	44,447 (100%)

[a] Includes both fast and normal track products
[b] Unprocessed agricultural products follow a delayed implementation schedule

Source: Joint Press Statement, Fourteenth AFTA Council Meeting, October 2000

<u>Temporary Exclusion List (almost) eliminated as scheduled</u>

Since January 1996, the core ASEAN member governments have transferred at least 20 per cent of products in their Temporary Exclusion List to the Inclusion List in accordance with the commitment made in 1994-95. The final instalment of products in the Temporary Exclusion List was moved to the Inclusion List at the start of 2000 as scheduled, and tariffs on these products brought down to 20 per cent, after which the rates will be reduced to 0-5 per cent by 2002/2003. Only the Temporary Exclusion Lists of Malaysia, Indonesia and the Philippines remain, and these only comprise 0.6 per cent of the total tariff lines of these countries (Table 2.8). Unfortunately, the products excluded are significant, with Malaysia, Indonesia and the Philippines excluding respectively automobiles, agricultural products and petrochemicals from CEPT/AFTA disciplines, leading to substantial tension with the other members, particularly in the case of automobiles and agriculture. Why these disputes arose and how they were dealt with will be discussed more fully in Chapters 5 and 6. Moreover, the number of products in the General Exemption List and the Sensitive Lists was also reduced (Tables 2.7 & 2.8).

Average CEPT tariff rates have fallen

The average regional CEPT tariff rate has fallen since AFTA was initiated, from 12.8 per cent in 1993 to 3.74 per cent in 2000.[38] Based on tariff implementation packages already committed to by the different countries, these rates are projected to fall further to 2.63 per cent by 2003 when AFTA will be completed (Table 2.9). The CEPT programme is, in fact, projected to reduce ASEAN average tariffs by as much as 70 per cent more than the reductions undertaken on an MFN basis (Azarcon, 1997: 123).

Averages can, and often do, mask substantial variation in tariff rates for individual products, however. In 1996 for instance, Malaysia, Indonesia and Thailand maintained tariffs in excess of 100 per cent on 29 per cent, 58 per cent and 11 per cent of their tariff lines respectively (Azarcon, 1997: 107-8). Incidentally, the regional average CEPT rate was 8.2 per cent (ASEAN Secretariat, 1996: 26). Yet in the same year, Malaysia also maintained a zero per cent tariff rate on a substantial 53 per cent of its total tariff lines, compared to figures of 19 per cent and 4 per cent for Indonesia and Thailand respectively (Azarcon, 1997: 108). In addition, tariffs on products still excluded remain high. Malaysia, for instance, continues to maintain tariffs ranging from 25 per cent to 300 per cent on imports of automobiles, which remain on the Temporary Exclusion List (Tyndall, 2000). Nevertheless, it is also important to keep in mind that about 90 per cent of all products in the combined ASEAN Inclusion List, itself representing about 98 per cent of total tariff lines in the core six ASEAN countries, are now at the 0-5 per cent tariff level (Table 2.10).

Table 2.9

Average CEPT Tariff Rates (%)

COUNTRY	2000	2001	2002	2003
Brunei	1.26	1.17	0.97	0.96
Indonesia	4.77	4.36	3.73	2.16
Malaysia	2.85	2.59	2.45	2.07
Philippines	4.97	4.17	4.07	3.77
Singapore	0	0	0	0
Thailand	6.07	5.59	5.17	4.63
ASEAN-10[a]	3.74	3.54	3.17	2.63

[a] Regional CEPT tariff rates are weighted averages, with the number of tariff lines in the Inclusion List for 1999 used as weights. Average regional tariffs for ASEAN-10 will tend to be higher than the average for the core ASEAN-6, as new members reach the 0-5% target rate at a later date.

Source: ASEAN Annual Report 1999-2000

Table 2.10

Number of Tariff Lines with Rates of 0-5% at Year 2000

COUNTRY	Number of Tariff Lines at 0-5% Tariff Rate	Percentage of Inclusion List (%) at 0-5% Tariff Rate
Brunei	6,106	98.0
Indonesia	6,327	88.4
Malaysia	7,809	88.2
Philippines	4,738	85.1
Singapore	5,739	100.0
Thailand	7,737	85.3
TOTAL	38, 456	90.0

Source: Press Statement, Thirteenth AFTA Council Meeting, Singapore, 29 September 1999

[38] See *ASEAN Annual Report 1999-2000*

Analysis of progress on tariff liberalisation in AFTA is complicated by the fact that shifts in tariff policy in the ASEAN countries during the 1990s were the outcome of developments on three fronts. During this period, ASEAN member governments undertook tariff reductions under three programmes: unilateral tariff reforms, tariff reductions agreed to under the GATT/WTO multilateral framework, and CEPT-based tariff reductions under AFTA. Thus, it will be useful to compare the CEPT rates in the ASEAN countries with the MFN or generalised tariff rates applicable to products from all sources.[39]

Generalised or MFN tariff rates were brought closer to CEPT rates on a wide range of products as MFN rates were unilaterally lowered across the core ASEAN countries, particularly between 1994 and 1996 (ASEAN Secretariat, 1996: 43).[40] Incidentally, unilateral measures were far more significant in these countries than the GATT process in reducing tariffs. Feridhanusetyawan *et al* (2000) also note that tariff reductions under Uruguay Round commitments were smaller than those negotiated under AFTA. Governments in Malaysia and Singapore, nevertheless, decided to extend CEPT tariff concessions to non-ASEAN traders on an MFN basis.[41] In Thailand, Indonesia and the Philippines, unilateral tariff reductions closely followed AFTA tariff reduction schedules

[39] Post Uruguay Round average MFN tariff rates in Indonesia, Malaysia and Thailand were actually higher than the prevailing applied MFN tariff rates in these countries, the difference ranging from about six to seven percentage points in Thailand and Malaysia to a hefty 25 percentage points in Indonesia (OECD, 1998: 17). Post Uruguay Round MFN tariff rates in Indonesia, Thailand, the Philippines, Malaysia and Singapore were respectively 40.3 per cent, 28.7 per cent, 22.2 per cent, 9.8 per cent and 5.1 per cent. See OECD (1998) and PECC (1995).

[40] The following unilateral/MFN tariff reduction programmes were undertaken. Brunei (one package in July 1995); Indonesia (four packages in May 1995, January 1996, June 1996; and July 1997); Malaysia (one package in October 1995); Philippines (one package in January 1996); and Thailand (two packages in December 1994 and May 1996). Thailand also lowered tariffs on intermediate products and raw materials to 0-5 per cent in January 2000. Tariffs were reduced once as a result of the GATT/WTO agreement of 1994. See Azarcon (1997); Nallappan *et al* (1998) and *Bangkok Post*, 'Protection remains for strategic sectors', 7 June 1999.

[41] See *Jakarta Post*, 18 May 1996.

(Pangestu, 1996: 9; Gochoco-Bautista, 1998: 210).[42] This raises the question of whether the CEPT and AFTA have become redundant. For instance, only about 1.5 per cent of intra-ASEAN trade in the mid-1990s utilised CEPT rules of origin certification, suggesting that CEPT-driven regional trade is very low (Teh, Jr. 1999). This was attributed to the prevailing small difference between CEPT and MFN tariff rates, which probably did not make it worth the while for manufacturers to apply for CEPT concessions.[43]

The picture is, however, expected to change as the completion date for AFTA approaches when CEPT and MFN rates are likely to increasingly diverge.[44] For instance, average MFN rates in 2000 in Thailand were about 19.9 per cent, compared to an average CEPT rate of 7 per cent, a substantial difference of almost 13 percentage points (Table 2.11). The respective MFN and CEPT tariff rates for the other ASEAN countries, shown in Table 2.11, similarly reveal a significant divergence of at least five percentage points in 2000. If MFN rates remain unchanged, the difference is expected to widen considerably in 2003.[45] If MFN rates also fall, the difference will narrow.

In Thailand, for instance, MFN rates are scheduled to fall further, but the difference between MFN and CEPT rates is, nevertheless, expected to be substantial.[46] Under Thailand's new tariff structure unveiled in 1999, the MFN tariff should exceed the CEPT

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[41] See *Jakarta Post*, 18 May 1996.
[42] The relationship between unilateral and CEPT/AFTA tariff reductions is discussed in Chapter 3.
[43] The then ASEAN Secretary General, Ajit Singh, pointed out in late 1996 that CEPT and MFN tariff rates were the same in about half of all tariff lines. See *Jakarta Post*, 10 October 1996.
[44] Interview in Jakarta in July 2000 with Dr Robert Teh Jr., Director of the Bureau of Trade, Industry and Services at the ASEAN Secretariat.
[45] Compare the 2003 CEPT tariff rates from Table 2.9 with the MFN tariff rates in Table 2.11.
[46] Interview in Bangkok in August 2000 with Ms Chularat Suteethorn, Director of the International Economic Policy Division, Ministry of Finance, Thailand.

rate by between 2-15 percentage points on average.[47] In selected sectors like petrochemicals, steel, automobiles and unprocessed agricultural products, MFN rates are expected to remain higher than that set down in the new tariff structure.[48] Thus, the CEPT-MFN differential should be even higher on these products. In Indonesia, the average MFN rate was scheduled to fall to a maximum 10 per cent by 2003, a significant five percentage points higher than the CEPT rate, although many individual MFN rates were set to fall to a maximum 5 per cent by 2000 (Nallappan *et al*, 1998: 50).[49] Implementation, however, has been delayed (Fane, 2000: 27), thereby maintaining the MFN-CEPT tariff differential.

Table 2.11

Comparison of MFN and CEPT average tariff rates, 1996 and 2000

COUNTRY	MFN Rate 1996	CEPT Rate 1996	CEPT Rate 2000	MFN and CEPT Tariff Rate (% divergence by 2000)[a]
Brunei	4.4	1.81	1.28	70.9%
Indonesia	12.4	8.36	4.6	62.9%
Malaysia	7.6	3.76	2.21	70.9%
Philippines	12.7	8.17	4.38	65.5%
Singapore	0.0	0.0	0.0	Nil
Thailand	19.9	13.95	7.08	64.4%

Note: There is a slight discrepancy between the 2000 CEPT tariff rates in this table and in Table 2.9 due to methodological differences in constructing tariff averages. The difference is minimal.
[a] Based on the assumption that MFN rates remain unchanged.

Source: Azarcon (1997: 122)

Unprocessed agricultural products – some progress but setbacks were also evident

The liberalisation of unprocessed agricultural products under CEPT disciplines was not expected to advance substantially due to the politically sensitive nature of the agriculture sector in most of the core ASEAN countries. It was, thus, encouraging that a significant 68.5 per cent of the total 2,025 tariff lines in agriculture were placed in the Inclusion List

[47] Under the new tariff structure, import tax on raw materials and primary goods is set at 0-5 per cent, 7 per cent for intermediate goods, and 15 per cent for final goods. See *Bangkok Post*, 'Protection remains for strategic sectors', 7 June 1999.
[48] *Bangkok Post*, 'Protection remains for strategic sectors', 7 June 1999.

when the initial commitment was made in 1994 to expand the scope of AFTA. Only 18.6 per cent of tariff lines were temporarily excluded while 12.9 per cent were deemed sensitive (Table 2.12). Unfortunately, the latter category included significant crops grown in the region, especially rice and sugar. Unlike the case of manufactured products, the unprocessed agricultural items included within the CEPT in 1994 accounted for less than a third of the value of intra-ASEAN agricultural imports.[50] A substantial 68 per cent of the value of intra-ASEAN imports of unprocessed agricultural products traded in ASEAN were excluded while more than one third was deemed too sensitive and thus exempted from CEPT/AFTA disciplines (Table 2.12).

Table 2.12

The Status of Unprocessed Agricultural Products in CEPT/AFTA, 1994

LIST TYPE	Number of Tariff Lines		Intra-ASEAN Import Value (US$ million)	
Inclusion	1,387	68.5%	125.68	31.6%
Temporary Exclusion	377	18.6%	130.7	32.9%
Sensitive	261	12.9%	141.15	35.5%
Total	2,025	100.0%	397.53	100.0%

Source: ASEAN Secretariat (1996: 29)

Moreover, a dispute emerged between Indonesia and Thailand when the former backtracked on its earlier commitment to reduce tariffs on 15 agricultural commodities, notably rice, sugar, cloves, and wheat flour. Negotiations to overcome the impasse were protracted, although it eventually led to the adoption of new categories and schedules for agricultural trade liberalisation formalised in a *Protocol on Sensitive and Highly Sensitive Agricultural Products*, which was signed by the economic ministers of ASEAN in

[49] These unilateral MFN tariff cuts were part of the May 1995 trade liberalisation package announced by the Indonesian government.

September 1999 (ASEAN, 1999). The dispute over agriculture will be discussed in detail in Chapters 5 and 6.

3.2 Reduction of Non-Tariff Barriers

A great deal of effort was put into reducing the incidence of NTBs to trade in ASEAN both jointly under AFTA as well as unilaterally (Feridhanusetyawan, 1998: 5). Member governments were aware that NTBs constituted a significant barrier to creating a regional market, even if full tariff liberalisation were achieved. The private business sector had, moreover, long expressed its view that NTBs constitute a serious obstacle to business in the ASEAN region (Baldwin, 1997: 58-60).

Customs surcharges, the main source of NTBs identified in ASEAN were completely eliminated by the end of 1996.[51] As already outlined in the previous section, technical NTBs, the next largest source of NTBs after customs surcharges, were to be addressed through programmes promoting transparency and harmonisation as well as through mutual recognition arrangements. These programmes have already commenced, with most of them ongoing while a few have been completed. In 2000, a draft text of a harmonised customs classification system for ASEAN, namely the *ASEAN Harmonised Tariff Nomenclature*, was reviewed to iron out remaining inconsistencies, and implementation is scheduled for 2002. (Pricewaterhouse Coopers, 2000). Member governments also began implementing the GATT Valuation Agreement in 1997, well ahead of the WTO deadline of 2000 for developing countries. These programmes will complement the Green Lane scheme for CEPT products that had been launched in January 1996 to accelerate customs

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[50] In contrast, the products in the 1994 CEPT Inclusion List for manufactured products accounted for 85 per cent of the total intra-ASEAN trade value. See Joint Press Statement, *Fifth AFTA Council Meeting*, Thailand, 21 September 1994.
[51] See the ASEAN *Annual Report 1996-97.*

clearance for CEPT products, although only a few companies initially made use of the Green Lane scheme (Baldwin, 1997: 59).[52]

A programme was also launched in 1996 to harmonise standards in 20 priority product groups that are significantly traded in ASEAN, using international standards where available. To this end, an *ASEAN Framework Agreement on Mutual Recognition Arrangements* was adopted in December 1998 (ASEAN, 1998f). This agreement provides the general principles and conditions for developing sectoral mutual recognition arrangements beginning with the 20 priority product groups, essentially electrical and electronic items, telecommunications equipment, and rubber products.[53] Harmonised standards in these product groups are expected to become operational in 2001. Other cooperative projects among customs authorities in the different ASEAN countries were also initiated with the aim of increasing the transparency of customs operations to facilitate regional trade.[54]

Despite these efforts, NTBs continue to persist,[55] particularly those arising from domestic regulations. A study conducted for APEC identified domestic regulations ranging from licensing requirements, state monopolies, health and sanitary restrictions, as well as banking regulations as significant NTBs in ASEAN (Baldwin, 1997: 58). Many of the NTBs deriving from import licensing rules and state monopolies were found in the agricultural sector, which explains why the majority of business complaints about NTBs in

[52] This was probably because in the initial years of the scheme, CEPT tariff rates did not differ too much from MFN rates, precluding the need for applying for CEPT concessions and rules of origin certification. See the discussion in Section 3.1 of this chapter.
[53] See the ASEAN *Annual Report 1996-97.*
[54] See ASEAN Secretariat (1998a: 21-27).
[55] *Bangkok Post*, 'Tarrin concerned over ASEAN non-tariff barriers', 10 September 1999.

ASEAN was directed at the agricultural rather than the manufacturing sector.[56] Although Indonesia was a major offender during the 1990s, particularly with regard to NTBs involving domestic monopoly arrangements, most of these were removed in 1999-2000 when the government implemented the economic reform packages negotiated with the IMF (Fane, 2000: 27).

ASEAN member governments also attempted to deal with NTBs by assigning a greater role to the private sector in identifying these barriers to trade. Firms were encouraged to lodge complaints over any difficulties they faced when exporting to another ASEAN country either directly to the AFTA Unit established in the respective national economic/trade ministries or to the AFTA Unit in the ASEAN Secretariat. This seems to be a reasonable step, given that NTBs are often invisible and only become apparent when traders are confronted by problems with exporting/importing. What happens once complaints are lodged, particularly if an NTB is identified, rests on inter-governmental negotiations rather than juridical or administrative mechanisms, which may well prevent a speedy resolution of the problem and introduce further uncertainty into the exercise.

3.3 The AFTA-Plus Programmes

As already noted, the AFTA-Plus programmes were more difficult to implement. Negotiations over the specific terms and conditions of these programmes were often protracted, especially in services. Nevertheless, it is significant that the ASEAN member governments committed potentially contentious sectors like services and investment to joint decision-making.

[56] See *AWSJ*, 'ASEAN takes another step towards free trade region', 11 September 1995.

Industrial cooperation and the AICO scheme

One of the selling points about the AICO scheme was its supposed administrative simplicity, with the entire process for the approval and granting of AICO privileges not taking more than 140 days (Baldwin, 1997: 64). Unfortunately, the reality was quite different, with considerable delays experienced by many private firms submitting applications.[57] Moreover, only 14 AICO applications were approved over two years between November 1996 when the scheme officially began and October 1998.[58] This was not for lack of private sector interest in the scheme. Many foreign business leaders complained about delays in processing applications and lack of transparency in approvals,[59] while the restrictive nature of the scheme meant that few approvals were given.[60]

One of these was the 30 per cent national equity requirement for participating companies, which prevented firms with less than the 30 per cent national equity share to be accorded AICO privileges.[61] Foreign firms, including those already operating in ASEAN, were often disadvantaged by this criterion. Member governments later agreed to allow the 30 per cent national equity requirement to be waived, although it was replaced by an ASEAN cumulative equity requirement and other conditions pertaining to the nature of the project (ASEAN Secretariat, 1997b: 40).[62] Unfortunately, individual governments had considerable leeway to decide on when they would grant these waivers, which meant that applications were often stuck at the approval stage if one of the host countries involved

[57] See *The Nation*, 'ASEAN told to speed up AICO to lure investors', 10 April, 1998.
[58] See Joint Press Statement, *Thirtieth ASEAN Economic Ministers Meeting*, Makati City, Philippines, 7-8 October 1998.
[59] *Business Times*, 'Obstacles to AICO implementation', 17 December 1997; and *Business Times*, 'Companies doubt ASEAN scheme', 23 August 1997.
[60] *The Nation*, 'Government encouraged to accelerate AFTA time-frame', 24 January 1998.
[61] ASEAN Secretariat (1997b: 5) explains how to calculate the 30 per cent national equity requirement.
[62] See also *The Nation*, 'AICO agrees to ease regulations', 3 March 1998.

was unwilling to consider waiving the national equity condition (Baldwin, 1997: 64). Member governments also relaxed other AICO criteria. New investors without any ongoing operations in ASEAN were allowed to submit applications for AICO. Previously, only firms already operating in the region could submit applications to be considered for AICO privileges. Since the financial crisis, the 30 per cent national equity requirement was unconditionally waived for firms submitting applications between 1 January 1999 and 31 December 2000. The deadline was later extended by a year to the end of 2001.[63]

These changes, which made it easier to obtain AICO approvals especially by foreign firms, were probably responsible for the rise in the number of AICO approvals to 36 by September 1999 and 63 by October 2000. These 63 applications had the capacity to generate a total of US$700 million in trade transactions per year.[64] In any case, the AICO scheme will become redundant as the deadline for the completion of AFTA approaches when tariffs are set to reach the 0-5 per cent level. In fact as already noted, this target was already reached in 2000 for almost 90 per cent of products traded among the core ASEAN countries.

Cooperation in services

The framework agreement adopted in 1995 set the stage for a series of further negotiations to obtain more specific commitments in market access, national treatment and other areas of services cooperation. A first round of negotiations commenced in 1996 and ended in December 1998. The negotiating process proved, however, to be rather difficult. Part of the problem was due to the modality of negotiations that was adopted. ASEAN officials

[63] See the ASEAN *Annual Report 1999-2000*; and the Joint Press Statement, *Thirty-Second ASEAN Economic Ministers Meeting*, Chiang Mai, Thailand, 5 October 2000.
[64] See the Joint Press Statement, *Thirty-Second ASEAN Economic Ministers Meeting*, Chiang Mai, Thailand, 5 October 2000.

submitted voluntary offer and request lists within specific service sectors to the Coordinating Committee on Services,[65] but these very often did not match. It was difficult to obtain a set of balanced concessions that all members were happy with in sectoral-based negotiations. Some quarters believe they may have been easier to obtain if negotiations covering all service sectors had been conducted, which would have facilitated the trading of concessions across sectors.[66] The approach presently adopted in ASEAN services negotiations is to initially obtain ministerial level commitments in different service sectors, and then to coordinate these further at a second stage.[67]

The first round of negotiations produced two packages of commitments, although these essentially outlined broad parameters for cooperation and did not detail substantive commitments.[68] Neither were offers forthcoming in all the seven service sub-sectors. An initial package of commitments in tourism, maritime transport, air transport, business services, and telecommunications, as well as a protocol of implementation were adopted in December 1997 (ASEAN, 1997). The arrangements were very flexible. Cooperation in these sectors did not involve all the ASEAN members. The AFAS allows two or more ASEAN members to proceed if the other members are not yet ready to participate in these cooperative arrangements. Thus, in the first package, only tourism cooperation involved all ASEAN members. Cooperation in maritime transport was confined to Brunei, Indonesia, Malaysia and Thailand; air transport cooperation involved Brunei, Malaysia and Singapore; and the Philippines offered concessions in business services.[69] A final

[65] The Coordinating Committee on Services reports to the SEOM.
[66] Interview with Mr Rodolfo C. Severino Jr., Secretary General of ASEAN in July 2000 in Jakarta.
[67] Interview with Dr Suthad Setboonsang, then Deputy Secretary General of ASEAN, in July 2000 in Jakarta.
[68] Interview with Dr Suthad Setboonsang.
[69] From an ASEAN press release, 'ASEAN Economic Ministers Sign Protocol to Implement Initial Package of Commitments under the ASEAN Framework Agreement on Services', Kuala Lumpur, 15 December 1997.

package of commitments together with its protocol of implementation was signed in December 1998 (ASEAN, 1998a). This second package went further than the initial package adopted in December 1997, with each government making offers in all seven service sectors.[70]

A second round of negotiations began in 1999 and is due for completion in 2001 when a third package of commitments will be adopted. This round of negotiations covers all seven services sectors. It is also targeted at all four modes of service supply, namely cross-border supply (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3), and the presence of natural persons (Mode 4). Initial commitments were made in Modes 1 and 2, which would allow service suppliers operating in ASEAN to provide services to users from another member country without establishing a commercial presence in that country. Negotiations are ongoing to obtain offers for Modes 3 and 4.[71] It has, however, been very difficult to get agreement on commitments that would allow non-national service firms to establish a market presence in an ASEAN country, particularly in very sensitive sectors like financial services and telecommunications.[72]

The removal of foreign equity restrictions in the service industry in Thailand and Indonesia, the result of their respective crisis-induced economic restructuring programmes, made these countries ready to commit to services liberalisation in ASEAN. This, however, also added to the difficulties already present in ASEAN in negotiating liberalisation commitments in services. Other governments had to contend with the prospect that services liberalisation would lead to even greater competition since foreign firms would

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[70] Interview in Jakarta with Mr Lim Hong Hin, Assistant Director in the Bureau of Trade, Industry and Services at the ASEAN Secretariat, July 2000.
[71] See ASEAN *Annual Report 1999-2000.*

find it easier to establish a commercial presence in these liberalised markets, and then sell their services to other, more closed service markets, like Malaysia for instance.[73] It prompted a Malaysian government official to remark that such a development did not allow preferential concessions for ASEAN service firms, since foreign service firms with domestic operations in ASEAN were just as likely to benefit from AFTA-based commitments.[74]

Investment liberalisation

It is difficult to comment on the implementation record of the AIA component programme as it is still in the early stages of implementation. The ASEAN governments are only scheduled to grant national treatment and market access to ASEAN investors in all manufacturing sectors by 2003 except in sectors placed on the sensitive list. The other sectors included within the AIA framework – agriculture, forestry, fisheries, mining and services incidental to all these sectors – are to be opened to ASEAN investors only from 2010. It is, nevertheless, clear that the ASEAN governments have placed most of the sectors they wish to exclude from the AIA into the Sensitive List rather than the Temporary Exclusion List (Table 2.13).[75] The former enjoys indefinite protection from foreign including ASEAN participation, at least under present rules, while the Temporary Exclusion List is scheduled to end in 2003. Most of the Sensitive List exclusions take the form of partial restrictions or additional conditions imposed on foreign investment, usually regarding land ownership; eligibility for government procurement privileges and

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[72] Interview with Mr Kong Mun Pew, Director of International Operations (Southeast Asia), Singapore Trade Development Board in August 2000 in Singapore.

[73] Unlike the AIA agreement, the AFAS did not restrict the benefits of ASEAN liberalisation in services to foreign service providers if the latter were engaged in substantive business operations in a member country (ASEAN, 1995d). In other words, foreign service providers already operating in an ASEAN country would be accorded similar privileges as a domestic service firm.

[74] Confidential interview.

[75] Details are found in the respective lists found in ASEAN Secretariat (1999b).

investment incentives; corporate equity conditions; employment of foreign employees; and other market access and export conditions. While the ASEAN governments' commitment to liberalise investment flows in ASEAN is laudable, implementation may be somewhat problematic if investment restrictions continue to be necessary for domestic political reasons. Although the Sensitive List, where most of the excluded or restricted sectors are placed, is to be reviewed periodically, precisely when the governments concerned will liberalise these sectors remained undecided at the time of writing.

Table 2.13

Temporary Exclusion List and Sensitive List for the Manufacturing Sector

	Temporary Exclusion List				**Sensitive List**			
Country	Industry Category							
	1	2	3	4	1	2	3	4
Brunei	Nil	Nil	X	Nil	X	X	X	Nil
Indonesia	Nil	Nil	X	Nil	X	Nil	X	Nil
Malaysia	Nil	Nil	Nil	Nil	X	Nil	X	Nil
Philippines	Nil	Nil	Nil	Nil	Nil	X	X	X
Singapore	Nil	Nil	Nil	Nil	X	Nil	X	Nil
Thailand	Nil	Nil	Nil	Nil	X	Nil	X	Nil

X: indicates the presence of restrictions.

Industry Categories
1: Industries closed to both foreign and national investment
2: Industries closed only to foreign investment
3: Industries open, but with restrictions on foreign investment
4: Others (not specified)

Source: ASEAN Secretariat (1999b: 1)

4. Conclusion

The preceding discussion describes how AFTA evolved between 1991 and 2000 from a project that initially focused on tariff liberalisation in manufacturing to include other, more politically sensitive issue areas like agriculture, investment and services. While an impressive range of commitments was made, the project's implementation record during the period under review was mixed. Tariff liberalisation in manufacturing was the most advanced, although Malaysia and the Philippines decided to temporarily exclude respectively automobiles and petrochemicals from AFTA disciplines. Member governments appear committed to reducing the incidence of NTBs as seen in the wide range of programmes completed as well as those that are ongoing in this issue area. On the other hand, agricultural trade liberalisation suffered significant setbacks. Progress was also more limited in obtaining commitments in services and investment liberalisation. Yet, this should not detract attention from the considerable advances made in AFTA over the decade, particularly when compared to the experience of APEC, which a number of scholars initially suggested would overtake AFTA.[76]

The distinctiveness of AFTA is clearly evident when it is compared to the previous phase of economic cooperation in ASEAN that began in 1976-77 and which effectively ended with the decision to establish AFTA.[77] During this early period of economic cooperation, practically everything of interest to regional cooperation seemed to be excluded (Mansfield and Milner, 1999: 603). Although a variety of specific cooperative projects had been adopted since 1976, these became bogged down in either inconsequential concessions that made a mockery out of the commitment to cooperation or because intransigent governments were unwilling to accord tariff and other concessions to firms and products from their regional partners.[78] Does this mean that during the 1990s the ASEAN governments were finally able to place regional interests above national ones? Or is it the case that it is precisely because domestic interests were threatened in some way

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[76] Buszynski (1997: 566) notes that a number of economists in the region did hold this view.

[77] Many of the projects initiated under the earlier phase of economic cooperation continued for some years even after AFTA was initiated, although they were eventually absorbed into the AFTA framework. Thus, the Preferential Trading Arrangement (PTA) was absorbed into the CEPT scheme of AFTA while two industrial cooperation projects (AIJV and the BBC) were replaced by the AICO.

[78] Comprehensive discussions of ASEAN economic cooperation between 1976 and 1990 are found in ASEAN Secretariat (1997a: 1-88); Frost (1990: 7-14); Suriyamongkol (1988); and Chng (1985).

that AFTA has been advanced? As the discussion in the rest of the dissertation suggests, globalisation presents significant challenges to domestic political economies in ASEAN, or is perceived as doing so, in turn prompting these governments to attempt to manage these external developments through regional collective action. In short, domestic and regional interests have become closely inter-linked in an era of globalisation. Precisely how systemic, domestic and regional dynamics interact in processes of regionalism is a major focus of the dissertation.

More specifically, the study involves three tasks. One of these tasks is to account for the AFTA project's initial adoption by ASEAN members as well as the substantial expansion in AFTA commitments that occurred during the course of the project. A second point that requires clarification pertains to the treatment of foreign investors in the investment liberalisation programme. If, as has been claimed by many scholars that AFTA is primarily an instrument to attract FDI, why have member governments chosen to grant preferential treatment to ASEAN investors ahead of foreign investors? Any explanation of AFTA must account for this anomaly. A third task is to explain the shift to a more cautious programme of trade liberalisation in unprocessed agricultural products, automobiles and petrochemicals, as well as the slow progress made in negotiating services liberalisation. Does this signal a weakening of the commitment to AFTA on the part of particular national governments, and if so, why did the member governments make the ambitious commitments they did in the first place? A related task is to explain how governments addressed the disputes that had emerged on some of these issues in AFTA. Chapters 3 through 6 attempt to provide answers to these key questions.

CHAPTER 3

GLOBALISATION, FOREIGN CAPITAL AND OPEN/NEOLIBERAL REGIONALISM: Contradictions and Inconsistencies in AFTA

1. Introduction

The previous chapter suggests, in its concluding section, that domestic and regional interests in ASEAN had become closely interrelated as a result of the pressures of globalisation, which led to the significant advances in AFTA that the chapter documented. In this chapter and the next, this argument is developed in some detail. More specifically, chapters 3 and 4 explain that AFTA was the outcome of the forces of globalisation that confronted the core ASEAN economies during the 1990s. These system-level dynamics, nevertheless, were mediated by the domestic political economy, which consequently led to two distinct types of regional projects within AFTA – open regionalism, to be discussed in this chapter, and developmental regionalism, which will be examined in Chapter 4.

This chapter reviews and expands on the arguments that have already been advanced to explain the emergence of AFTA as a project of open regionalism. Structural changes in the pace, nature and pattern of global investment flows during this period are commonly cited to account for open regionalism in AFTA. AFTA, it is often argued, was used by its members to counter the threat of FDI diversion away from the ASEAN economies amidst intense international competition for globally mobile investment capital.[1] Accurate to a degree, this dissertation demonstrates that the concern with FDI was only part of the AFTA story, albeit an important one.

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[1] See the discussion in the introductory chapter.

The FDI explanation has been discussed at length in the literature and will not be repeated here, except to re-iterate its main points. Instead, the chapter emphasises how the structural power of foreign investment capital, *reinforced by its key role in the domestic political economy of the ASEAN countries*, made AFTA vital as a means of defining a distinctive space of production for global capital in the wider Asia-Pacific region, particularly in competition with China. Sections 2, 3 and 4 discuss these points. Section 5 argues that although AFTA was a project of open regionalism aimed at engagement with the global economy, it displayed only limited neoliberal characteristics. Moreover, there was a clear departure from open regionalism when member governments agreed to privilege domestic investors over foreign investors in investment liberalisation. This puzzle, yet to be accounted for in the literature, forms the point of departure for Chapter 4, which discusses developmental regionalism.

2. The Structural Power of Foreign Capital

The pressure to establish a regional free trade area in ASEAN did not come from investors engaged in some form of direct lobbying of ASEAN governments. Instead, it was exercised through the structural power of foreign capital given by its vastly growing potential to relocate to alternative investment sites and its value as a source of key productive assets for governments wishing to integrate their respective economies with an increasingly competitive world economy. While globalisation shaped these two elements, the dynamics of the domestic political economy reinforced these structural pressures through the key role assigned to foreign investment capital in national economic growth.

Foreign investors had not been active in the deliberations that led to the 1991 decision to establish AFTA (Lim, 1994: 132). In fact, many foreign investors, including Japanese investors who were key investors in ASEAN, were surprised by the ASEAN decision, with some decidedly pessimistic about the project's viability.[2] Although Japanese firms, particularly automobile firms, had already begun to engage in a regional division of labour in ASEAN by the early 1990s, the Japanese had not pushed for a region-wide free trade area (Lim, 1994: 133). This was because Japan's "private, public-private and state-level arrangements" helped to coordinate and support the regional activities of Japanese firms that would have otherwise required a formal regionalist scheme (Doner, 1997). As such, a generalised free trade area had been somewhat unnecessary to Japanese investors, and may even erode Japan's comparative advantage in the region compared to other foreign investors who were not backed by the kinds of informal institutions that supported the regional activities of Japanese firms. Despite some initial doubts in Japanese business and policy circles, the Japanese government and the powerful Japanese peak business organisation, the *Keidanren* or Japan Federation of Economic Organisations, quickly registered their support for AFTA. A senior official of the Japanese Ministry of International Trade and Industry lauded the "positive move on ASEAN's part ... [in] taking the initiative without having been asked by the major foreign investors."[3]

Rather than direct pressure by investors, it was the structural power of foreign capital that was significant in influencing the AFTA decision, and later, its consolidation and expansion. Officials preparing for the 1992 Singapore Summit at which the decision to establish AFTA was formally adopted admitted that one of the most compelling arguments advanced for AFTA, and which convinced the leaders of its necessity, was its capacity to attract FDI to the region (Akrasanee and Stifel, 1992: 36). Most observers of ASEAN had not expected such a decision to be adopted, given the difficulties the grouping had

[2] *New Straits Times*, 'Delegate: Thai proposal not viable', 25 July 1991.
[3] *Business Times*, 'Japan throws weight behind AFTA scheme', 13 January 1993.

experienced in pursuing economic cooperation in the past and its rejection of the idea of a free trade area as recently as 1987 at the Third ASEAN Summit in Manila.

It is worth emphasising this point, as it shows that the ASEAN leaders were convinced of the utility of AFTA only when it was expressed in terms of the project's economic benefits for their respective economies. It weakens the argument advanced in the literature that AFTA was primarily adopted as an economic instrument to achieve strategic purposes – to keep ASEAN relevant as a regional organisation in the changing strategic environment. At most, the strategic motivation driving AFTA was an initial though secondary objective that was, in any case, overtaken by the FDI imperative. A senior Malaysian trade official, Mr Razak Ramli, acknowledged that "since 1992, the picture got clearer with regard to the economic motivations behind AFTA".[4]

As discussed in the introductory chapter, it is inconceivable that the ASEAN leaders would have embraced a project that had the potential to introduce real changes to domestic economies if AFTA had not also promised economic benefits. These economic benefits came in the form of the potential to attract the necessary FDI to support high growth strategies in the core ASEAN economies and to ensure their engagement with the world economy. Thus, the initial idea mooted by Thai Prime Minister Anand Panyarachun in 1991 quickly found support in all the ASEAN capitals. In the early 1990s, economic growth in the ASEAN countries was believed to be under threat as FDI inflows, a crucial source of growth, showed a declining growth trend, especially in terms of relative shares (Table 3.1).

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[4] Interview in Kuala Lumpur in August 2000. Mr Razak is Deputy Secretary-General of the Ministry of International Trade and Industry, Malaysia.

Table 3.1

Flows of FDI to host region/economy, 1983-1998 (US$ million)

Host region or economy	Total Flows	Developed countries	All Developing countries	ASEAN countries [a]	China
1983-88	91,554	71,779	19,757	3,708 (5.2%)	1,823 (2.5%)
1988	159,101	131,313	27,772	6,991 (25.2%)	3,194 (11.5%)
1989	200,612	171,722	28,622	7,591(26.5%)	3,393 (11.9%)
1990	211,425	176,436	34,689	12,158 (35.0%)	3,487 (10.1%)
1991	158,936	114,792	41,696	13,400 (32.1%)	4,366 (10.5%)
1992	173,761	119,692	49,625	12,074 (24.3%)	11,156 (22.5%)
1993	219,421	133,850	78,813	15, 994 (20.3%)	27,515 (34.9%)
1994	253,506	146,379	101,196	19,681 (19.4%)	33,787 (33.4%)
1995	328,862	208,372	106,224	21,643 (20.4%)	35,849 (33.7%)
1996	358,869	211,120	135,343	25,980 (19.2%)	40,180 (29.7%)
1997	464,341	273,276	172,533	27,813 (16.1%)	44,236 (25.6%)
1998	643,879	460,431	165,936	21,400 (12.9%)	45,460 (27.4%)

[a] Includes all ten ASEAN member economies

Figures in parentheses refer to investment flows as a proportion of total flows to developing countries

Sources: UNCTAD, World Investment Report, 1999
ASEAN Investment Database as reported in ASEAN Secretariat (1999a:131-32).

2.1 The Lure of Regional and/or Large Markets

These pressures alone do not explain what prompted the *regional* response, since ASEAN governments could well have adopted further unilateral reforms or used incentives at the national level to make individual economies more attractive to FDI without engaging in regionalism. It was the awareness, or at least perceptions, on the part of ASEAN leaders and policymakers that FDI was attracted to large and/or regional markets – NAFTA, the Single European Market (SEM) and especially China – that demonstrated to ASEAN leaders the potential utility of a similar project in ASEAN.

Two developments in the world economy during the early 1990s dominated the concern with FDI diversion, and helped shape the ASEAN response. The ASEAN governments had come to realise that the formation of regionalist projects in the developed world, notably NAFTA and the SEM, were not so much a threat to free trade as much as a potential source of competition for global production capital. Here, the analyses and views of European and North American economists and policy analysts on the implications of NAFTA and the SEM for other countries and regions, including ASEAN, were keenly followed by ASEAN policymakers, and were no doubt persuasive (Means, 1995: 149). While many of these studies reached diverse conclusions, most were agreed that the largest impact would be on FDI inflows to ASEAN rather than on trade diversion. In addition, the ASEAN governments saw the emergence of China as an alternative, and potentially more attractive location for foreign investors compared to the far smaller individual ASEAN economies due to China's vast market.

The important point to note is that the interest shown by foreign firms in investing in NAFTA, the SEM and China demonstrated to ASEAN policymakers the potential of large and/or regional markets in attracting FDI inflows. It made the idea of a single regional market in ASEAN more compelling. The views of the ASEAN leaders can be summed up in the words of Thailand's Prime Minister in 1993, Chuan Leekpai who cautioned that "the possible diversion of direct foreign investment to emerging groupings such as the SEM and NAFTA is a perpetual reminder that smaller countries have to unite".[5] The Head of the Indonesian Board of Investment acknowledged that ASEAN investment officials had, in 1993, "agreed to work together to invite foreign investors to invest in ASEAN".[6] The idea was for the ASEAN countries to cooperate in presenting AFTA as a single regional site for FDI. Trade officials from Malaysia confirmed that selling AFTA as an attractive investment location was a key objective of ASEAN.[7]

Despite initial fears centred on NAFTA and the SEM, by 1993, China became far more significant as a competing investment location to ASEAN. The call in January 1992 by

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[5] *Business Times*, 'Stepped-up liberalisation of trade can be expected: Chuan', 8 January 1993.
[6] *Business Times*, 'Indonesia seeking closer collaboration with Singapore', 25 June 1994.

Chinese leader Deng Xiaoping for faster and deeper economic reforms in China sparked off an investment boom in that country (Tan, 1993: 11). The sharp rise in FDI flows to China since then was seen as being increasingly at the expense of the ASEAN countries (Tables 3.1 & 3.2). Since 1992, the surge of FDI from the Asian NIEs to ASEAN moderated, with an increasing proportion of Japanese, Taiwanese and Hong Kong investment flowing to China instead (Parker, 1993: 61).[8] Investments from OECD sources, including North American and European sources, to ASEAN similarly weakened (Thomsen, 1999: 16). Thus, by the end of 1992, the FDI situation in the core ASEAN countries had become extremely worrying to policymakers and political leaders.

Table 3.2

Flows of FDI to the core ASEAN countries, 1983-1998 (US$ million)

Host economy	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand
1983-88	--	341	731	249	1,947	439
1988	--	576	719	936	3,655	1,105
1989	--	682	1,668	563	2,887	1,775
1990	1	1,093	2,332	530	5,575	2,444
1991	1	1,482	3,998	544	4,887	2,014
1992	4	1,777	5,183	228	2,204	2,114
1993	14	2,004	5,006	1,238	4,686	1,805
1994	6	2,109	4,342	1,591	8,550	1,364
1995	13	4,346	4,178	1,478	7,206	2,068
1996	11	6,194	5,078	1,517	7,884	2,336
1997	5	4,673	5,106	1,222	9,710	3,733
1998	4	356	3,727	1,713	7,218	6,969

Source: UNCTAD, World Investment Report 1999
ASEAN Investment Database as reported in ASEAN Secretariat (1999a: 132)

3. Domestic Political Economy Dynamics: Reinforcing the Structural Power of Foreign Capital

ASEAN policymakers, notably the leaders, recognised the threat to economic growth, and thus to regime legitimacy and security, to which any diversion of FDI from the ASEAN

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[7] *Business Times,* 'KL poised to take centre stage in AFTA', 18 September 1993.

region would contribute. FDI had, by the end of the 1980s, become a crucial source of economic growth in the core ASEAN economies.[9] It was through FDI that these countries had emerged from the recession of the mid-1980s to engage in outward-oriented industrialisation and to become significant exporters of manufactured goods. FDI also introduced the necessary technology and management/organisational skills that enabled the ASEAN economies to plug into international production networks. Foreign investment was, thus, "aggressively encouraged" by these governments (Parker, 1993: 54).[10] These concerns with FDI and growth were, moreover, underpinned by political imperatives as well, thereby reinforcing quite substantially at the domestic level the structural forces associated with global capital.

3.1 Thailand

The initial idea for AFTA, which came from the Thai government of Anand Panyarachun in 1991, can be traced to concerns of the new, post-coup elite in Thailand with the fall in FDI. Urban business had, together with the bureaucrats, formed an alliance with the military in the aftermath of the 1991 military coup, largely as a result of the military's appointment of Anand, a widely respected corporate figure and former career diplomat, as caretaker Prime Minister before democratic elections could be held. While the military justified the coup as a means of ousting the corrupt government of Chatichai Choonhavan (1988-91), urban business welcomed the fall of the Chatichai government under which the influence of provincial business had grown at its expense (Phongpaichit and Baker, 1995: 355-56).

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[8] Investors from the Asian NIEs, together with the Triad economies – the US, Europe and Japan – constituted the largest source of FDI to the ASEAN region. See Tan (1993) and Tham (1998).

[9] This point is well covered in the literature and will not be repeated here. See especially Parker (1993) and Tham (1998).

[10] Singapore had begun to promote FDI since the 1960s, and thus already had a liberal FDI regime. While Malaysia had also embarked on export-oriented industrialisation since the 1970s, its foreign investment regime was only substantially liberalised from the mid-1980s after the recession.

Whatever the internal political dynamics and motivations behind the coup, one result was a fall in foreign investor interest in Thailand as expectations of rising political instability in the country grew (Phongpaichit and Baker, 1995: 356). This worried not only the caretaker government of Prime Minister Anand, who in June 1991 had initially broached the idea of AFTA to the other ASEAN leaders, it was also of concern to the Bangkok business elite, which benefited from FDI through extensive joint-venture arrangements (Phongpaichit and Baker, 1995: 156). At a more general level, the Thai economy had become increasingly reliant on exports and FDI since the late 1980s. In 1992, the number of investment applications fell by 31 per cent, with the biggest decline – 45 per cent – registered in Japanese investment applications (Tan, 1993: 13). Worried Thai investment officials, thus, planned 'offensive' strategies to promote FDI into Thailand (Tan, 1993: 14).

In addition to these purely economic concerns, there was also the ever-present fear that the military would re-assert its influence should economic growth falter. The military had played a substantial role in Thai politics and economics in the past, but its power and influence had waned significantly since the late 1980s, notwithstanding the military coup in February 1991. The transfer of power from the military elite to a democratically elected civilian government after the 1991 coup was expected to have been complete by 1992 with the election of the Chuan government. Nevertheless, the military continued to assert itself behind the scenes during 1993 and 1994, demanding a large military budget, a military role in development, and the rehabilitation of the army's political role in the interests of national security (Phongpaichit and Baker, 1995: 364). This was worrying to the new elite coalition in Thailand made up of reforming bureaucrats, ruling politicians, and the Bangkok-based business elite. Although urban business had initially aligned itself with the military, the alliance was shaky from the start and the business elite soon distanced itself from the military (Phongpaichit and Baker, 1995: 356). The concern over FDI and growth took on added significance in this context, particularly since Thailand had a long history of military coups being triggered by domestic economic upheavals.[11]

3.2 Malaysia

In Malaysia, approved investment from Japan, a major investor, fell 30.6 per cent in 1991, while that from Taiwan, a growing investor, fell by 58.3 per cent. If petroleum projects were excluded from the Malaysian investment figures, manufacturing sector FDI in Malaysia registered a staggering decline of 60 per cent in 1992. Policymakers were especially anxious because of a fall in domestic investments in Malaysia coupled with a 42 per cent decline in foreign investment applications in 1992 over the previous year (Tan, 1993: 12-13). The decline in FDI approvals in Malaysia was partly due to the government becoming more selective of FDI, preferring projects involving higher levels of technology, skills and capital (Tan, 1993: 13). Nevertheless, policymakers were clearly worried by the substantial fall in FDI.

Policymakers were aware that foreign capital remained a key source of economic growth as well as a means to technological and industrial upgrading, the latter a vital element of Prime Minister Mahathir's Vision 2020 programme to transform Malaysia into a developed country by 2020 (Khoo, 1995: 327). This prompted the Malaysian Ministry of International Trade and Industry to step up its international investment promotions in order to "pre-empt any slowdown (in FDI)".[12] Malaysian policymakers had, by this time, also recognised that China was the country's prime competitor for it (Means, 1995: 163).

[11] See Alagappa (1987).
[12] *Business Times*, 'Domestic investments paying off', 11 July 1994.

As in Thailand, ensuring FDI also had important political implications in Malaysia through its role in ensuring growth, a crucial means to political stability. High levels of economic growth brought significant benefits to much of Malaysian society while also enabling the government to maintain its affirmative action programme for the country's ethnic Malay majority without excessively eating into the wealth shares of other ethnic groups. It also provided the resources needed for the government's patronage machinery, which helped to maintain elite cohesion and thus, the stability of the government and regime (Crouch, 1996: 246).[13]

Malaysia had embarked on FDI-led growth as a way out of the mid-1980s recession, during which time latent cleavages among the political elite had become extremely pronounced, threatening the ruling government, Prime Minister Mahathir's personal authority, and the Malay/UMNO-dominated political regime (Crouch, 1996: 106-13).[14] The rift was especially deep within UMNO, and between the ruling Malay party and its ethnic Chinese coalition partner, the Malaysian Chinese Association. At the same time, rising unemployment and an increase in private bankruptcies led to generalised public discontent with the government and regime, which inevitably led to communal tensions as each ethnic group in multiethnic Malaysia saw the other groups as the cause of its own difficulties. These ethnic tensions within Malaysian society were exploited, and thus, exacerbated, by incumbent elites and their challengers leading to expectations of a repeat

[13] The governing elite in Malaysia had always included politicians from the major political parties in the ruling National Front coalition representing the three major ethnic groups in the country. By the late 1980s, prominent businesspersons, especially those from the majority ethnic Malay and minority ethnic Chinese communities, became closely allied with political elites to form the dominant elite coalition in Malaysia. See Case (1996).

[14] UMNO is the United Malays National Organisation, the dominant Malay political party in the ruling multiethnic National Front coalition that has governed Malaysia since independence. Its President and Deputy President become respectively the Prime Minister and Deputy Prime Minister of Malaysia.

of the May 1969 ethnic riots in the country. The deteriorating political situation was, however, arrested through political manoeuvring and coercive action by the ruling government in the short-term (Crouch, 1996: 106-13). The resumption in economic growth, the result of domestic economic reforms and the fortuitous inflow of FDI from the Asian NIEs during the late 1980s also helped to restore growth and consequently, political stability. It is, thus, unsurprising that the FDI situation in the early 1990s should be a cause for concern, given its implications for growth and distribution, particularly in view of recent events in the country.

3.3 Indonesia

Although FDI increased in Indonesia in 1992 (Table 3.2), this was largely attributed to several large petroleum and mining projects. If these projects were excluded from the figures, FDI actually fell by 54 per cent in 1992, compounded by the equally sharp decline in domestic investments. These developments prompted considerable concern in Indonesia (Tan, 1993: 13; van der Eng, 1993: 20-21). Since the start of the country's economic reform programmes in the 1980s, Indonesia had received significant amounts of FDI, especially from the Asian NIEs.

While the relative share of FDI in the Indonesian economy was less than that of domestic investments, its importance for the Indonesian economy and for growth rests on its high export propensity and its use of more sophisticated technology compared to domestic investors (Lindblad, 1997: 29; Djidin, 1997: 32). Moreover, the government's plan to attain an average annual growth rate of six per cent during the Sixth Development Plan (*Repelita VI*) (1993-98) rested on an investment target of 60 trillion rupiah (US$28 million) over the five-year period (Surbakti, 1999: 75). Domestic private and state investments were not expected to be able to sustain the needed capital investment, especially in the light of the downturn in domestic investments during the early 1990s (MacIntyre and Sjahrir, 1993: 12). The critical role of FDI was, thus, underscored.

Foreign capital was vital to maintaining economic growth in the country. Growth was a crucial regime-legitimating device for President Suharto, which allowed him to consolidate his political rule over an essentially fractious nation by steadily improving living standards for Indonesians in general and enabling large numbers of ordinary Indonesians to engage in economic activity (Surbakti, 1999: 62). The President also used the material benefits generated by that growth to win friends and co-opt potential adversaries within the state and more broadly in society (Liddle, 1999: 48). In short, economic growth provided the ruling elite, notably the President, with the resources necessary to accomplish economic and political goals through patronage politics (Surbakti, 1999: 62-65). The flow of FDI from the NIEs to China rather than to Indonesia from 1993 was, therefore, viewed with alarm by the Indonesian authorities, made worse by indications that some firms already established in Indonesia were considering a move to China (Means, 1995: 169). A senior Indonesian investment official acknowledged China to be Indonesia's main competitor for FDI.[15]

3.4 Singapore

Although the diversion of FDI from ASEAN to China did not affect Singapore directly, Singaporean policymakers were concerned about the indirect effects on the Singapore economy, particularly its service sector, should economic growth in Indonesia and Malaysia falter as a result of the decline in FDI (Tan, 1993: 15). Singapore had, by the early 1990s, embarked on a services-led growth strategy, moving away from the island republic's traditional manufacturing-led growth strategy of the 1960s to 1980s, and began emphasising the city-state as the operational and business headquarters for the regional production operations of TNCs.

The 'regional service strategy' was, thus, premised on the growth of manufacturing production, not so much in Singapore but in the other regional economies of Southeast Asia, in which Singapore-based TNCs helped to coordinate and service. Any fall in investment to the rest of ASEAN would, thus, threaten Singapore's services-led growth programme.[16] This explains why Singapore's political elite constantly played on the issue of FDI diversion to China, even though Singapore was far less directly affected by the diversion of manufacturing investment to China. Moreover, the political legitimacy of the Peoples' Action Party (PAP) that had ruled Singapore since independence in 1965 was derived from its capacity to preside over improved material conditions, making growth a political imperative as well as an economic one (Rodan, 1989: 202).

3.5 The Philippines

In the Philippines, the Ramos government elected in 1992, having inherited an economy in severe crisis, proposed an ambitious development plan – Philippines 2000 – that aimed to take the country to NIE status by century's end, a mere eight years away. This required a minimum 8 per cent average annual growth rate to be achieved by, among other means, economic liberalisation and FDI (Vos and Yap, 1996: 163). The recourse to FDI took on added significance with the decision by the government to close the US air and naval bases in the Philippines in 1992, which led to the withdrawal of foreign assistance from Washington (Hutchison, 1997: 85). This, coupled with the continuing high foreign debt

[15] *Business Times*, 'Indonesia seeking closer collaboration with Singapore', 25 June 1994.
[16] See Rodan (1993).

burden, led to increased reliance on FDI for growth. In fact, the foreign sector assumed a dominant part in Ramos' 'Philippines 2000' programme (McFarlane, 1998: 173).

Thus, the threat of FDI diversion was a serious one for the Philippines government, which had, like other states in the region, come to regard China as one of its main competitors in the FDI game (Gochoco-Bautista, 1998: 211). The economic liberalisation programme initiated by Ramos also included a political dimension as well. It was designed to challenge the power of the old landed, agricultural oligarchy, which had re-emerged with post-Marcos democratisation as key players in the new Philippine 'elite democracy', this time in new areas of the economy like industry, banking and services rather than in agriculture (Hutchison, 1997: 83).

4. AFTA: Creating an Alternative Regional Space in the Asia-Pacific for Investment and Production

Concern in the region over the potential to lose FDI to China was, therefore, quite pronounced. ASEAN policymakers were correct to identify China as their biggest competitor for it. Although other markets, particularly regionalist schemes elsewhere, did have the potential to attract FDI away from ASEAN, China was especially significant because it was part of the Asia-Pacific region. Global capital had, by the early 1990s, adopted a regional focus to its investment and production strategies (Ng and Sudo, 1991). This changing logic of global capital meant that TNCs were increasingly practising a regional as opposed to global division of labour, and establishing production in different regions – Europe, North America, and the Asia-Pacific. This was discussed in some detail in Chapter 1. While the aim of TNCs was to operate business globally, that goal was being increasingly achieved through the development of "complete and integrated production and management systems within definable regions" (Rodan, 1993: 234).

China by itself offered such a 'regional' site for FDI in the Asia-Pacific region, given its (potential) market size.[17] What the ASEAN governments attempted to offer to foreign investors through AFTA was an alternate regional space of investment and production that exploited the 'regional' logic of global capital. AFTA, thus, helped to define a distinctive functional space of production in the wider East Asian/Asia Pacific region. Only through AFTA did the ASEAN leaders and policymakers believe they could meet the FDI challenge from China, particularly as they had reached a limit in terms of the individual investment incentives they could offer potential investors. As an Indonesian investment official explained, "they (the Chinese) give everything ... they give all the incentives which we could not give".[18]

Thus, most scholars agree that fear over the diversion of FDI to China was a major reason why the ASEAN leaders agreed to consolidate the regional project and begin tariff reductions by January 1994 despite the emergence of domestic business resistance to AFTA in a number of member countries. Political leaders also found the potential threat to economic growth from falling levels of foreign investment sufficiently overwhelming to advance AFTA further in 1994-95 (Hay, 1996). ASEAN leaders consequently shortened by five years the time frame when tariffs in AFTA would reach the 0-5 per cent target, introduced new rules to govern the temporary exclusion list scheme, and agreed to adopt both a dispute settlement mechanism and an agreement to protect intellectual property rights in ASEAN. By doing so, they were signalling to foreign investors that they were

[17] A study carried out by the Economist Intelligence Unit identified 'Greater China' (China, Hong Kong and Taiwan) as ASEAN's closest rival for the title of fastest growing sub-regional market in the wider Asia-Pacific region (Baldwin, 1997: 3). Although the regional financial crisis qualifies this assessment, the point remains that ASEAN and China present alternative regional market sites for investors interested in the Asia-Pacific region.
[18] *Business Times*, 'Indonesia seeking closer collaboration with Singapore', 25 June 1994.

committed to the development of AFTA as a single regional space of production. Moreover, the AICO scheme was adopted as a compromise between the need to attract foreign investors through forming a single market and giving domestic industries sufficient time to adjust to AFTA tariff liberalisation. Notwithstanding the problems investors encountered in getting AICO approvals, the scheme effectively fast-tracked AFTA for selected products on application by investors.[19]

4.1 The New Issue Areas: Additional Dynamics?

The FDI explanation is also used to account for the inclusion of agriculture, services and investment within AFTA in 1994-95 (Hay, 1996: 266-68). The argument is that ASEAN governments wished to keep AFTA relevant to FDI, given the advances made in the GATT as well as in APEC and NAFTA during the mid-1990s in addressing agriculture, services and investment.[20] The additional commitments were necessary in order to maintain AFTA as a distinctive regional space of investment and production. This explanation is incomplete, however. It is unable to explain why ASEAN investors were treated more favourably than foreign investors in the AIA component of AFTA. While a case may be made that concern with FDI diversion was a factor prompting the inclusion of services and investment within AFTA, Chapter 4 argues that expanding AFTA's scope to include investment reflected not merely growth as a goal, *but the development of domestic capabilities as well.* The latter led to deviations in AFTA from open regionalism.

In the case of agriculture, its incorporation into world trade disciplines as a result of the Uruguay Round agreements was largely responsible for its subsequent insertion into

[19] AICO is discussed in Chapter 2 (Section 2.2).
[20] Developments in the GATT/WTO and APEC are discussed in Chapter 4.

AFTA.[21] The incorporation of agriculture into the GATT/WTO helped the Thai government, which had originally wanted AFTA to cover agriculture, a key export sector for the country, to successfully lobby for its inclusion in the CEPT despite the reservations of other governments, notably Indonesia.[22] The Malaysian, Philippine and Indonesian governments, however, insisted on having a separate arrangement to govern trade liberalisation of the more sensitive agricultural items. Despite making this request, the Indonesian government unilaterally withdrew 15 agricultural products that it had earlier included within the CEPT, which led to a dispute with Thailand. Why this happened and how it was addressed is discussed in Chapters 5 and 6. It is sufficient, at this point, to note that it would have been difficult for the Thai government to advocate including agriculture in AFTA if it had not already been incorporated within the WTO, given the significant reservations in the region on the issue. Nevertheless, the other governments agreed to its inclusion despite these reservations in order to reinforce AFTA as a project of open regionalism. As Malaysia's Minister of Primary Industries said in 1994, "it is a logical and natural action wanting to include agricultural products into CEPT since the world community is committed to free trade liberalisation".[23]

4.2 The Financial Crisis Period

The decision by member governments to further accelerate AFTA as well as introduce additional investment incentives in the region in 1998-99 was also driven by concern with FDI and growth (Bowles, 2000: 444). The core ASEAN governments had to make sure that their respective economies remained attractive to FDI amidst the economic turmoil of the regional financial crisis, and they attempted to accomplish this through regionalism.

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[21] The general commitments in the Uruguay Round agreement on agriculture are detailed in Feridhanusetyawan (1998).
[22] See *NST*, 'Thailand takes on regional leadership', 1 October 1994.
[23] *Business Times*, 'Need to address problems in ASEAN's farm sector', 26 August 1994.

As huge amounts of portfolio capital began flowing out of these economies, the imperative of maintaining direct investment became paramount, especially since domestic investments had also suffered a sharp contraction in the region (OECD, 1999: 120). AFTA became a key tool in the process of maintaining foreign investor confidence in the region, particularly as China still loomed as an alternative investment site.

Thus, Bowles (2000: 444) points to the joint adoption of a temporary incentive package in 1998 (Table 2.6 in Chapter 2) that gave foreign investors additional incentives in each ASEAN country over a two year period as evidence that the ASEAN governments were using regionalism to attract FDI. As already noted in Chapter 2, the most significant of these incentives was the temporary offer of 100 per cent foreign equity and market access, mostly in manufacturing. The acceleration of the CEPT, the temporary relaxation of the 30 per cent national equity requirement in AICO and arguably the acceleration of the AIA were the other measures jointly adopted by the ASEAN governments in order to maintain investor confidence during a time of economic distress. The recognition by ASEAN policymakers of the need for joint measures in ensuring foreign investor interest in the region was also reflected in their decision to embark on joint investment promotion missions in 1999-2000 to the major investor countries/regions – the US, Europe, and Japan – a first in ASEAN's history.[24]

Bowles (2000: 445) also acknowledges that beneath the level of official discourse on open regionalism, protectionist elements emerged to strain intra-ASEAN relations, with both tariff and non-tariff barriers used to shield domestic industries during the financial crisis. Others go further in denying the considerable advances made in AFTA since its inception

[24] See the press release from the ASEAN Secretariat, "ASEAN to send investment missions to the US and Europe", 14 April 1999.

by pointing to the adoption of tariff and non-tariff barriers during this period as evidence of AFTA's failure.[25] This is too stark a position. While the adoption of tariff and non-tariff barriers was a setback for AFTA and did strain regional relations, its significance for evaluating progress in AFTA should not be exaggerated.

Many of the import restrictions were announced as temporary for a one to two year period, and were generally part of a set of short-term fiscal measures designed to reduce immediate pressure on countries' external accounts. Thus, a large proportion of tariffs were used to restrict big-ticket items, including luxury imports, transport equipment, and capital goods like steel and heavy machinery (Shimizu, 2000: 83). In the Philippines, tariffs were raised on certain textile, steel and petrochemical products in response to business demands, but for one year.[26] The Philippine government rejected additional business demands for protection because, as Trade Secretary, Jose Pardo pointed out, protection "sends the wrong signal (to international investors)".[27] The point to note is that these particular 'protectionist' moves were brought on by the pressures of recession, and should be assessed in that context. The important thing is that despite these temporary deviations from AFTA commitments, AFTA tariff liberalisation was on target and the majority of CEPT commitments fulfilled as Chapter 2 shows. The notable exception was the temporary delay in including automobiles and petrochemicals, respectively by Malaysia and the Philippines, under AFTA disciplines.

While Bowles (2000: 444) sees the temporary incentive package as an indication of ASEAN's continued use of regionalism to sustain the FDI-led growth strategy in member countries, this chapter interprets the incentive package somewhat differently. While not

[25] See, for instance, Clad (2000).
[26] *Jakarta Post*, 5 March 1999.

denying Bowles' point, this chapter suggests that its significance lies in its temporary nature. The removal of restrictions on foreign equity and market access conditions in the package when it was announced was limited to investment applications made between January 1999 and December 2000 only, subject to further review. Moreover, the 30 per cent national equity requirement in AICO was waived for only two years until 2000, later extended by a further year.[28] These short-term measures are, thus, a curious anomaly, given the overwhelming pressure to maintain investor confidence and interest in the ASEAN region because they raised doubts about the commitment of the ASEAN governments to neoliberal economic reforms.

The short-term nature of these measures suggests that equity ownership and market access remained a sensitive issue in the ASEAN countries. Although Malaysia extended the incentive period until the end of 2003, its temporary nature remains unchanged at the time of writing. While many of Thailand's and Indonesia's temporary liberalisation offers were eventually incorporated into these countries' unilateral and IMF-led reform programmes, this does not alter the main thrust of the argument – that national governments were sensitive, for various reasons, about equity and market access issues. These sensitivities were also reflected in the AIA programme. Although the AIA was accelerated in 1999 in direct response to the crisis, only ASEAN investors were to receive the benefits of full market access and national treatment in 2003 in the manufacturing sector and 2010 in other sectors, while foreign (non-ASEAN) investors were scheduled to receive these benefits in 2020. This rather contradictory move, which did not appear to be helpful to the FDI cause, has still to be explained. It suggests that there were other dynamics, apart from

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[27] *Jakarta Post*, 7 April 1999.

[28] A number of scholars questioned the significance of these short-term measures when they were announced, and asked whether they would prove sufficiently attractive to investors during a period of economic turmoil (Soesastro, 1999: 9).

the FDI threat, that shaped the development of AFTA, particularly its AIA programme. As the next chapter reveals, domestic political priorities centred on the need to nurture domestic capital influenced the design of the AIA.

5. AFTA: A Neoliberal Regionalist Project?

Despite the anomaly in the AIA, the open regionalism credentials of AFTA, particularly of the CEPT scheme, cannot be doubted given its primary purpose to engage with globalisation, notably globally mobile FDI. One key feature of open regionalist projects is that the exchange of preferences among regional partners is not accompanied by the imposition of new barriers to non-partners. AFTA, having no common external tariff, clearly met this condition. Apart from its broadly open regionalist character, is AFTA also a project of neoliberal regionalism? Scholars like Bowles (2000) believe that it is, despite instances of protectionism during the financial crisis period. This section engages in a more careful assessment of this claim, using insights from Chapter 1 on neoliberal and embedded neoliberal regionalism as a guide.

5.1 The Formal Design of Regional Trade Liberalisation

Apart from the absence of a common external tariff, AFTA's neoliberal credentials were reflected in the way members were allowed to unilaterally and voluntarily extend CEPT tariff preferences to non-members on an MFN basis. It meant that the ASEAN member governments were not denied the chance to adopt unilateral economic reforms that went faster or beyond the CEPT in order to meet the unique competitive needs of the domestic economy, provided CEPT commitments were met at the very minimum.

Although member governments availed themselves of this privilege on a number of occasions, the extension of CEPT preferences to non-members was not always practised, however. This is revealed in Table 2.11 in Chapter 2, which shows the fairly significant divergence in the CEPT and MFN average tariff rates in 2000 and that expected in 2003, particularly in Thailand and Indonesia. Nevertheless, despite multilateralisation of the CEPT being a less than universal practice in reality, the presence of an option to extend CEPT tariff reductions to non-ASEAN members on an MFN basis reinforced the neoliberal credentials of AFTA.

Whether governments multilateralised their CEPT commitments was influenced by two developments, namely by the presence of unilateral economic reform programmes and the need to reduce CEPT-induced tariff distortions. Malaysia, Indonesia, Thailand and the Philippines were engaged in an ongoing process of unilateral economic reforms from the mid-1980s.[29] These economic reforms had initially been undertaken to overcome the economic recession of 1985-86, or, in the case of the Philippines, the economic crisis unleashed by the Marcos regime. They were designed to create the conditions for export-oriented, FDI-led growth. In that context, it made sense to extend AFTA tariff offers to all parties. Tariff reductions under the CEPT framework in AFTA thus dovetailed with unilateral tariff reforms.

In many cases, AFTA tariff reduction commitments drove or preceded unilateral (MFN) reform packages. Thus, the Indonesian deregulation package of May 1995 extended CEPT tariff reduction commitments outlined the previous year to all parties (Fane and Condon, 1996: 53-54; James, 1995: 32). In the Philippines, AFTA forced a change in the pace of economic reforms, with AFTA used to push unilateral trade liberalisation (Gochoco-Bautista, 1998: 210). AFTA, more fundamentally, also influenced the nature of economic policy in that country. Jesus Estanislao, the Chairman of the Philippine AFTA

Commission, admitted in 1993 that AFTA would lead to "a radical departure of the policy orientation" of the Philippine government.[30] In Thailand, general tariff reform was undertaken as part of the country's preparation for AFTA (Krongkaew, 1997: 24). A senior Thai Finance Ministry official noted that "CEPT actually pushes Thailand's MFN tariff reforms".[31]

In addition, distortions in tariff structures in countries like Thailand and the Philippines required the reduction in import duties on raw materials and intermediate inputs to be undertaken on an MFN basis before or at the same time that AFTA commitments came into force. Because inputs that went into manufactured products like textiles were largely imported from outside ASEAN, high MFN tariffs on these inputs in Thailand and the Philippines made final goods less competitive compared with products made in Malaysia and Singapore where MFN input tariffs had been reduced much earlier. Once tariffs on final goods were reduced to a uniform 0-5 per cent under AFTA, manufacturers in Thailand and the Philippines would have been at a disadvantage if MFN tariffs on relevant inputs were not reduced correspondingly. Final goods manufacturers in Thailand and the Philippines thus lobbied their governments to streamline tariff structures, and particularly to lower duties on imported inputs on an MFN basis to maintain the competitiveness of their products relative to those produced in the other ASEAN countries with less distorted tariff structures.

The textile industry in Thailand was among the worst hit. Thai textile firms urged the government to hasten tariff reform in Thailand before tariffs on final textile products fell

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[29] See Chapter 2 (footnote 40).
[30] *Business Times*, 'AFTA will force Manila to change economic policies', 15 December 1993.
[31] Interview with Ms Chularat Suteethorn of the Ministry of Finance, Thailand, August 2000.

to 0-5 per cent under the country's AFTA commitments.[32] Thai textile producers were levied MFN import duties of between 20-40 per cent on raw materials and inputs, which were largely imported from non-ASEAN sources, thus placing them at an enormous disadvantage compared to producers from Malaysia. These concerns led to a review of Thailand's tariff structure in 1999, when the import duty for raw materials and primary goods was set at between 0-5 per cent on an MFN basis, in line with the AFTA rate and those of the other countries.[33]

Trends such as these confirm the neoliberal characteristics of AFTA. The competitiveness of domestic industry was not to be compromised by any desire to maintain preferential tariffs among AFTA member countries to privilege product sourcing only from within ASEAN. The aim, after all, was to use AFTA to create a regional space of production through removing internal barriers to the free movement of economic resources. It was not primarily designed to increase intra-ASEAN trade, although regional trade would be expected to eventually rise if investors established transnational production in ASEAN.

5.2 The Dominant Discourse: Globalisation, Competitiveness and Efficiency

While the specific design of the CEPT indicated its neoliberal credentials, the discourse or discourses associated with AFTA were also revealing of the kind of regionalist project that was being constructed in AFTA. Actors construct and use discourses to tell particular stories about the world. Discourses help in creating a cognitive structure that in turn helps shape the expectations of other actors about the world as well as their behaviour given a set of expected constraints and opportunities.

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[32] *The Nation*, 'Textile group pushes for cut in input duties', 9 November, 1999.
[33] *Bangkok Post*, 'Protection remains for strategic sectors', 7 June 1999.

The discourse associated with AFTA was centred on the neoliberal tenets of competitiveness and efficiency. It thus reflected the dominant discourse in the core ASEAN countries that also stressed the importance of competitiveness and efficiency for firms and the economy in meeting the challenges of globalisation (Soesastro, 1998). In all these countries, national governments used the notion of 'globalisation' to justify and push through domestic economic reforms through deregulation, liberalisation and privatisation.[34] Moreover, competitiveness and efficiency were seen as vital for these economies in the competition to attract FDI and to ensure their integration with the world economy. While these countries cooperated in attracting FDI through regionalism, they also engaged in designing investment programmes, including competitive liberalisation, that were aimed at directing FDI that had been attracted in the first instance by the prospect of the AFTA market to their respective national economies (Rinakit and Soesastro, 1998: 198). The option of multilateralising the CEPT and the absence of a common external tariff in AFTA allowed competitive liberalisation to take place. It is in this sense that a neoliberal discourse may be said to have underpinned AFTA.

The discourse, centred on globalisation, competitiveness and efficiency, was one constructed and dominated by policymakers, and directed at private business. Its goal was to justify economic reforms in general, and tariff liberalisation in particular, and to make private business aware that it would no longer enjoy tariff protection as in the past. Substantial domestic business opposition to AFTA had emerged since the project was

[34] See Rinakit and Soesastro (1998) and Murphy (1999) on Indonesia; Gochoco-Bautista (1998) on the Philippines; Chantana (1998) and Hamilton-Hart (1999b) on Thailand; and Welsh (1999) on Malaysia.

initially announced, and governments attempted to use discourse as one means of legitimising economic reforms, including unilateral and CEPT trade liberalisation.[35]

Thus, the Thai Deputy Prime Minister in 1993, Dr Supachai Panitchpakdi pointed to 'competitiveness' as the main challenge for Thailand, and acknowledged that "we are using AFTA to force competitiveness on [local businesses], so you work with low protection".[36] This was a message repeated by successive Thai governments since then.[37] Malaysian companies were continuously warned to brace themselves for international competition with the implementation of AFTA. Trade Minister Rafidah Aziz explained that liberalisation of the domestic market would "enable local industries to build up the resilience required to face competition".[38] The Philippine Foreign Secretary urged domestic firms to shape up for AFTA, which would "force ASEAN industries to be globally competitive".[39] In Indonesia, responses to globalisation were framed in terms of enhancing the international competitiveness of firms (Rinakit and Soesastro, 1998: 199). Coordinating Minister for National Development Planning in 1996, Ginandjar Kartasasmita, re-affirmed the Indonesian government's commitments to AFTA during discussions with the business sector, warning businesses that the era of government protection of Indonesian firms was over.[40]

Other groups apart from policymakers, notably pro-reform business leaders and liberal economists, were often active participants in the dominant neoliberal discourse as well.

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[35] Nevertheless, the CEPT incorporated sufficient flexibility, as Chapter 2 shows, to give firms sufficient time to adjust to the eventual removal of protection. In addition, both Thailand and the Philippines introduced financial support programmes to help domestic industries hurt by AFTA. See *Business Times*, 'Bangkok sets up fund to help local industries', 14 June 1993; and *Business Times*, 'Philippine govt to help industry compete in region', 19 November 1992.
[36] *FEER*, 'Thailand: Trade and Investment', 5 August 1993.
[37] See *The Nation*, 'Coming to terms with free trade', 8 April 1997.
[38] *Business Times*, 'Rafidah: open market can create resilience', 17 August 1992.
[39] *Business Times*, 'Philippines unveils economic blueprint', 20 November 1992.

This is not to deny the presence of alternative discourses. These did exist, and were focused on the negative aspects of globalisation, including its environmental, social and cultural effects. Nevertheless, during the high growth period of much of the 1990s, the neoliberal discourse of adjusting to globalisation through promoting competitiveness and efficiency was dominant in these countries and spearheaded by policymakers.[41] This was also the discourse associated with AFTA.

During the 1990s in Thailand, the debate was between the globalisers and the localists, although the globalisers were predominant. Thai policymakers, notably the powerful technocrats in the civil service, interpreted globalisation as a force compelling neoliberal economic policies, and responded accordingly in policy formulation. Other advocates of the competitiveness discourse included the newly emergent commercial interests and the long-established Bangkok business elite, in addition to the technocrats – notably liberal economists in the Ministry of Finance, the central bank and the planning agency (Hamilton-Hart, 1999b: 293). Various policy documents were issued since 1994 that emphasised competitiveness as the strategy to respond to the pressures of globalisation (Chantana, 1998: 266).

These policies were fully supported by elite business interests – essentially the Bangkok-based conglomerates – who favoured a liberal economic environment with an eye to the benefits that foreign capital brought to their own ventures as joint partners as well as in boosting the stock market. For instance, large Thai corporations like Siam Cement, Charoen Pokphand, the Saha Union, and the leading banks were favoured partners for foreign investors (Phongpaichit and Baker, 1995: 156). Other business players outside the

[40] *Republika (Republic)*, 27 September 1996.

group of Bangkok-based conglomerates were less embracing of liberalisation. The globalisers, however, dominated public policy and were able to implement their agenda of liberalisation, while the far less coherent localists were marginal in policy terms (Hamilton-Hart, 1999b: 287-94). The Thai discourse of competitiveness and efficiency surrounding AFTA derived from the broader globalisation discourse. Despite the crisis, the predominant discourse in Thailand remained the neoliberal one (Hamilton-Hart, 1999b: 301-302), at least until the election of Prime Minister Thaksin Shinawatra in January 2001 whose government appears to be less embracing of the neoliberal discourse and the liberal economic policies of previous governments.[42]

In countries like Indonesia and Malaysia, however, alternative perceptions and responses to globalisation and neoliberalism were present even before the financial crisis, though the latter brought these alternative discourses into sharper relief (Welsh, 1999; Murphy, 1999). These alternative interpretations of globalisation led these governments to adopt particular policy responses in AFTA that appeared to contradict its open/neoliberal regionalist character. This will be discussed in detail in the next chapter. Nevertheless, both Indonesia and Malaysia were also preoccupied with the notion of competitiveness, which also dominated the discourse on globalisation in Singapore (Yeung, 1999).

The attitudes and responses of both Malaysian and Indonesian policymakers were largely shaped by the ideas and responses of their respective leaders. As Welsh notes, a large portion of the Malaysian Prime Minister's Vision 2020 document outlining the strategies by which Malaysia would attain developed country status by 2020 emphasises neoliberal market reforms (Welsh, 1999: 266). Yet, Dr Mahathir did not fully embrace the western

[41] Since the financial crisis, however, opposing discourses have become more prominent (Soesastro, 1998).

notion of globalisation and its associated neoliberal policies in all areas of policy. As Chapter 4 shows, Dr Mahathir re-interpreted globalisation to emphasise its negative implications for developing countries and their firms as well, which also underpinned the Malaysian government's position on AFTA's investment liberalisation programme.

In Indonesia, President Suharto's broad response to globalisation was not to oppose it, but to adjust to it (Rinakit and Soesastro, 1998: 193-94). Nevertheless, although Indonesian economic policy during the 1990s moved in a broadly neoliberal direction, well-connected big business and powerful political groups were able to influence policy away from the neoliberal agenda in specific cases that were of direct interest to them. This is discussed in Chapter 5. Nevertheless, the ideal of competitiveness was a strong one in Indonesian policy circles, reflected in the extensive neoliberal reforms undertaken, although it did not go unchallenged in both ideational and policy terms as the discussion in Chapter 4 shows. As in the Malaysian case, these alternative discourses were also reflected in Indonesia's response to the AIA.

Unlike the European case, the competitiveness discourse in the ASEAN countries was initiated and constructed by public policymakers rather than business and corporate actors, and centred on creating a cognitive structure that would legitimise the withdrawal of protection and the adoption of other neoliberal policies that may disadvantage private business. The aim was to drive home the point to the private sector that economic reforms, including tariff liberalisation, were here to stay and protectionism would not be entertained. This growth-centred policy was, however, breached on a number of occasions. In the EU, on the other hand, transnational business elites and their allies had succeeded in defining the discourse surrounding European integration in terms of competitiveness and

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[42] See *FEER*, 'Thailand Incorporated', 18 January 2001.

efficiency that required a reduction in the scale and scope of state involvement in and regulation of national economies (van Apeldoorn, 2000: 241). The discourse in ASEAN was somewhat different, particularly with regard to the state-market relationship.

5.3 The State-Market Relationship: AFTA and 'Embedded' Neoliberalism

To the extent that neoliberalism also encompasses the notion of limited government involvement in or direction of the economy, then the neoliberalism inherent in the competitiveness discourse surrounding AFTA, and in AFTA itself, was a limited or partial one. Although it incorporated the notion of business or private sector-led growth, this did not include the associated neoliberal idea of more market and less state at all levels of governance.

In practice, neoliberalism was largely confined to the international trade regime, while at the domestic level, governments continued to regulate and impose restrictions on business activity, including foreign investors, despite domestic economic reforms in the core ASEAN countries. Chapter 4 discusses these regulations and restrictions in detail. Moreover, all the core ASEAN governments were actively engaged in supplying the necessary public goods like education, skills, and infrastructure to support business activity and attract FDI rather than leaving them to the free market to supply.[43] As such, while AFTA, particularly through the CEPT, encompassed neoliberal features, the neoliberalism inherent in AFTA more broadly was only partial or limited.

[43] See Rinakit and Soesastro (1998) on Indonesia; Gochoco-Bautista (1998) on the Philippines; Chantana (1998) on Thailand; and Welsh (1999) on Malaysia.

6. Conclusion: Contradictions and Inconsistencies

One of the most notable contradictions in AFTA, and where its departure from the open or embedded neoliberal regionalism of the CEPT is clearest, is found in the investment liberalisation programme. As already noted at various points in this chapter, the privileging of ASEAN investors over foreign investors in the AIA is curious given the significant concern among the ASEAN member governments to remain attractive to FDI. Significantly, the terms of the AIA relating to ASEAN and non-ASEAN investors were also not altered during the crucial period of the financial crisis when it would have seemed logical not to jeopardise the already precarious economic climate. Paradoxically, when the AIA was accelerated in 1999 in response to the financial crisis, the benefits of earlier market access and national treatment were directed at ASEAN investors only, while non-ASEAN (foreign) investors were only to receive these benefits at the original 2020 target date. The ASEAN Secretary General, in fact, sought to play down this distinction between ASEAN and foreign (non-ASEAN) investors in the AIA scheme in a bid to reassure foreign investors.[44] What is puzzling is that this distinction was maintained despite the marked reductions in FDI to ASEAN in general and individual member countries in particular.

A report by the ASEAN Secretary General submitted to the ASEAN Foreign Ministers in July 2000 showed that FDI inflows to the region dropped from US$28 billion in 1997 to US$13.1 billion in 1999. All member economies, except Singapore, registered declines in FDI in 1999.[45] The report also showed that ASEAN economies received 17 per cent of FDI flows to Asian developing countries in 1999, compared to about 60 per cent during the early 1990s. China, on the other hand, received about 60 per cent in 1999 compared to

[44] *Business Times*, 'ASEAN set to liberalise investment within region', 30 September 1999.
[45] *IHT*, 'Investment in Southeast Asia plunges', 27 July 2000.

18 per cent during the early 1990s. The negative correlation was not lost on ASEAN officials and leaders.[46] China's potential accession to the WTO also added to the sense of urgency among the ASEAN leaders with regard to the FDI situation in view of the anticipated diversion of FDI to China that would likely follow China's membership of the multilateral trading system. The ASEAN economic ministers requested a study on how the accession of China to the WTO would impact on regional trade and especially investment.[47]

How do we explain this particular anomaly in AFTA, especially in the face of economic adversity when reassuring foreign investors would have been the logical step? It is insufficient to merely cite the emergence of protectionism in one or more of the ASEAN countries or of policy inconsistency as explanation. We need to delve deeper and ask what could have accounted for this departure from open regionalism even though the growth and FDI imperative remained strong during the 1990s in ASEAN, and particularly after the onset of the regional financial crisis in 1997. Clearly, other dynamics were at work in addition to the growth and FDI dynamic that drove AFTA. In essence, these dynamics revolved around the political role of domestic capital in elite governance political systems. The next chapter examines these dynamics in greater detail.

[46] *Financial Times*, 'Foreign investors desert Southeast Asia for China, 13 October 2000.
[47] *Financial Times*, 'Chuan urges ASEAN to move on free trade', 6 October 2000.

CHAPTER 4

GLOBALISATION, DOMESTIC CAPITAL AND DEVELOPMENTAL REGIONALISM:

The Mediating Role of Domestic Politics

1. Introduction

The previous chapter suggests that there were other dimensions to the AFTA story, apart from open regionalism and the concern with FDI, that have so far been ignored in the literature. This was clear from the AIA Agreement, which sought to offer full market access and national treatment privileges to ASEAN investors ahead of foreign (non-ASEAN) investors. The discrimination against foreign investors was all the more puzzling since key officials in ASEAN acknowledged that the AIA was part of the wider goal in AFTA of maintaining ASEAN's attractiveness as a site for FDI.[1] It is not possible to ascribe this move to protectionist governments concerned with protecting national investors, since the AIA did not completely prevent market competition for any national investor.[2] Nor did the AIA keep out foreign investors; it merely offered all ASEAN national investors the same privileges accorded to domestic investors. Nevertheless, it is clear that this particular clause in the AIA sought to privilege ASEAN domestic capital, at least temporarily. It is, therefore, the role of domestic capital in the domestic political economy that is key to explaining the AIA anomaly.

This chapter argues that AFTA also incorporated developmental characteristics through the AIA component, in addition to open/embedded neoliberal regionalism in the CEPT. The AIA offered the possibility for domestic firms to expand within the larger regional

[1] Interviews with Dr Wee Kee Hwee of the ASEAN Secretariat in July 2000 and with Mr Razak Ramli of Malaysia in August 2000. Also see Rafidah (2000).

[2] By 'national' investor is meant an investor who is regarded as a domestic investor in a particular state. It does not refer to a public/state investor.

market, including forming joint ventures and other forms of alliances with other ASEAN firms, through exploiting the preferential investment privileges the AIA would accord them ahead of foreign investors. Nevertheless, developmental regionalism in AFTA was also about engaging with globalisation, except that certain policymakers and leaders were not prepared to accept the hegemony of foreign TNCs that was a growing feature of globalisation, and attempted to nurture domestic firms and capabilities as well. The growth imperative was, thus, infused with domestic priorities pertaining to domestic capital.[3]

Before elaborating on this argument, it is necessary to address the possibility that the distinction the AIA made between ASEAN and foreign investors was not all that significant given what appeared to be fairly liberal FDI regimes in the countries concerned. This was particularly the case for investment in the manufacturing sector that was targeted for earlier liberalisation to ASEAN investors in 2003. Some scholars, in fact, maintain this view (Menon, 1998: 18). Section 2 addresses this point. Following this, Sections 3 and 4 discuss how expected changes in multilateral rules, especially on investment, raised concerns in some ASEAN countries with regard to the future of domestic firms in global competition, which in turn led to the adoption of a developmental component in AFTA through the AIA. Section 5 explains the concern with domestic capital in terms of its political role in the domestic political economy of ASEAN countries.

[3] The dissertation recognises that domestic capital is not a homogenous group, instead comprising various segments. Nevertheless, the term '*domestic* capital' is employed in the study to distinguish it from *foreign* capital, a distinction that is crucial to the dissertation's main argument. The discussion that follows takes into account the different segments of domestic capital where relevant.

2. National FDI Regimes and the AIA

Investment regimes in the core ASEAN countries comprise at least seven categories in which restrictions or differential treatment of foreign over national investors can be maintained. These seven categories cover (a) sectors open to investment, (b) equity ownership, (c) fiscal incentives, (d) taxation, (e) banking and financial regulations, (f) employment conditions and (g) land ownership.[4] While the first category is relevant to the AIA market access offer, the rest of the six categories are relevant to the national treatment issue. If significant conditions or restrictions were imposed on foreign investors compared to national investors in one or more of these categories, then the AIA proposal to accord national treatment privileges to ASEAN investors ahead of foreign investors would be significant.

2.1 Thailand

During the 1990s, Thailand's investment regime was governed by two pieces of legislation. The Investment Promotion Act of 1977 (revised in 1992) outlined all incentives available to both Thai national and foreign investors in priority investment sectors while the 1972 Alien Business Law (ABL-72) provided guidelines on foreign equity participation. The latter was especially restrictive, and long subject to demands from foreign business for its review or repeal.[5] ABL-72 protected 63 business categories across a range of sectors in manufacturing, services, commerce, agriculture, transportation and construction from full and/or majority foreign participation, unless export conditions and/or promoted status were fulfilled.[6] Under the Thai Land Code, foreign investors were not permitted to purchase land unless operating in a priority sector, although limited 30-

[4] These categories are described fully in ASEAN Secretariat (1998b: 1-3).
[5] *The Nation*, 'Pressure grows to end Alien Business Law', 12 December 1997.

year leases were allowed. Investors generally prefer longer periods of lease for security of tenure, with 99-year leases being the norm in industrial countries, while owned land is useful as collateral for local borrowing provided it is permitted (Thomsen, 1999: 21). When the AIA was initially adopted, these restrictions on foreign investments were in force under ABL-72. This made the AIA distinction between a national/ASEAN investor and a foreign investor significant.

In March 2000, ABL-72 was replaced by the Foreign Business Act of 1999, which liberalised conditions for foreign investment in Thailand.[7] It reduced the number of business sectors restricted to foreign participation from 63 to 42, allowed greater access to foreign majority ownership in Thai industries, and offered liberal land leases of 50 years, renewable for a further 50 years.[8] On the other hand, restrictions on foreign participation remained in many sectors including agriculture and services, particularly computer and electronics services while new, more restrictive investment rules were introduced to tighten the conditions under which foreign business operated in Thailand.[9] For instance, ABL-72 expanded the definition of 'foreign' business to include ventures in which foreigners exercised virtual management control despite owning less than 50 per cent equity.[10]

The 1999 Foreign Business Act, thus, continued to make the AIA distinction between foreign and ASEAN investors a significant one indeed, particularly in the non-

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[6] ABL-72 restricted foreign equity to 49 per cent unless a 50 per cent export condition was met. Majority foreign ownership was allowed in priority activities, however, but again, this required 50 per cent or more of the output to be exported.

[7] Information on the Foreign Business Act 1999 was obtained from the website of the Thailand Board of Investment (www.boi.gov.th).

[8] See *The Nation*, 'Wider access to trades, land', 26 August 1998.

[9] According to Paisan Kumanwisai, panel chaiman of the Senate committee for vetting aliens. See *The Nation*, 'Alien business law', 19 June 1999.

manufacturing sector. Many of the restricted activities under the new Thai law fell under the AIA categories of forestry, fishing, mining, agricultural activities and in services 'incidental' to manufacturing. While ASEAN investments in these non-manufacturing sectors were to be accorded AIA privileges only in 2010, the point to note is that the AIA distinction between ASEAN and non-ASEAN investors had not become irrelevant under the new investment law. Then Thai Deputy Prime Minister Dr Supachai Panitchpakdi had also insisted that any new law replacing ABL-72 would not accord national treatment to foreign investors despite the latter's strong preference for it.[11]

Moreover, the new, populist government of Prime Minister Thaksin Shinawatra elected in January 2001 began to show signs that it was considering tightening the conditions of foreign participation in the economy, especially in still protected sectors like insurance, finance, and even in heavy industries like steel.[12] Thaksin's promise to the Federation of Thai Industries in February 2001 to amend laws that "work against Thai interests" and for Thailand to cease being a "slave to the world" won the new government much political support.[13] It reflected the anti-western and anti-globalisation mood in the country, which was a response to the extensive liberalisation undertaken by the previous Chuan government both unilaterally as well as under the conditions imposed by the IMF in its bailout package for Thailand during the financial crisis. Given the substantial public and domestic business criticism that had been directed against the Foreign Business Act during its formulation stage,[14] it remains to be seen whether the liberal provisions in the Act are maintained, particularly since the Act itself allows for an annual review process.

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[10] ABL-72 had only considered businesses in which foreigners held more than 50 per cent equity to be alien or foreign businesses.
[11] *The Nation*, 'Thailand to offer 100% bank equity', 3 December 1997.
[12] *FEER*, 'Thaksin turns back the clock', 19 April 2001.
[13] *Ibid.*
[14] *The Nation*, 'Officials told to explain need to amend laws', 26 November 1998.

2.2 Malaysia

Malaysia has maintained a liberal FDI regime in manufacturing since the mid-1980s, the only significant restrictions being those on foreign equity ownership. Nevertheless, majority and full foreign ownership is permitted provided certain export conditions are fulfilled.[15] The Promotion of Investments Act (1986) that liberalised the FDI regime after the 1985 recession allows full foreign ownership in manufacturing provided more than 80 per cent of production is exported, while majority foreign ownership is allowed if more than half the produced output is exported. As in Thailand, the presence of these restrictions on foreign ownership made the AIA clause offering earlier national treatment to ASEAN investors potentially significant.

During the financial crisis, the Malaysian government temporarily relaxed foreign investment rules, as did the other ASEAN countries.[16] While the more relaxed FDI regime initially applied to investments made between 31 July 1998 and 31 December 2000, it was later extended until the end of 2003, subject to further review.[17] Despite these changes to FDI rules, equity restrictions remained in several categories of manufacturing activities[18] to protect the operations of small and medium-scale Malaysian-owned enterprises that dominated these activities and that had the potential to act as suppliers to the larger MNCs. Many were, in fact, already doing so. These activities were also likely to be attractive to national investors from the other ASEAN countries.

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[15] See Malaysia (1998).
[16] See Table 2.6 in Chapter 2.
[17] Information on Malaysian investment policy is available on the website of the Malaysian Industrial Development Authority, the country's investment agency (www.mida.gov.my).
[18] See ASEAN Secretariat (1998b: 34-40).

Equity restrictions also remained in many service sectors, including in banking where the 30 per cent cap on foreign equity remained sacrosanct despite pressures arising from the financial crisis to raise the equity ceiling. Malaysia also maintained restrictions on the amount that foreign investors could borrow from domestic banking sources (ASEAN Secretariat, 1998b: 78). This particular restriction on domestic borrowing was especially likely to hinder investment from medium-scale enterprises from the ASEAN countries. As such, the AIA commitment to offer earlier market access and national treatment to ASEAN investors was a significant gesture, particularly if the temporary relaxation in equity and market access restrictions is not extended after 2003.

2.3 The Philippines

The 1987 Omnibus Investment Code substantially liberalised the FDI regime in the Philippines, allowing up to 100 per cent foreign equity in priority sectors. Although the 1991 Foreign Investment Act further liberalised investment rules (McFarlane, 1998: 163; Austria, 1998: 80), the government continued to maintain equity limits and other conditions on foreign investors as part of the 'Filipino First' clause of the Constitution (Thomsen, 1999: 21). Full foreign equity ownership was permitted in all manufacturing activities open to foreign investors,[19] provided at least 60 per cent of output was exported. Otherwise a 40 per cent foreign equity limit was imposed, or 65 per cent in the iron and steel sector (ASEAN Secretariat, 1998b: 49-51). The provision of investment incentives was also dependent on equity conditions (ASEAN Secretariat, 1998b: 50). Non-Filipino companies were required to become Filipino companies within 30 years by reducing the foreign ownership ratio to less than 40 per cent. Companies that exported all their output

[19] Although progressively shortened throughout the 1990s, a negative list of activities either closed to foreign participation or in which only limited foreign participation is permitted, was maintained. Austria (1998: 111-15) lists these restricted sectors/activities.

were exempted from the divestment requirement, however (ASEAN Secretariat, 1998b: 35).

As for land ownership, only Filipino companies, and/or companies with at least 60 per cent domestic equity were allowed to own land (ASEAN Secretariat, 1998b: 101).[20] Otherwise, foreign investors were permitted to lease land for 50 years. Although former President Joseph Estrada (1998-2001) proposed to remove all restrictions on foreign ownership of land and utilities, substantial domestic opposition prevented such a move. Even Estrada's predecessor, Fidel Ramos (1992-98) who had presided over extensive neoliberal reform of the Philippine economy, opposed offering parity of equity rights to foreign nationals (Bolongaita, Jr, 2000: 69). Thus, the Philippine FDI regime maintained significant restrictions on foreign investment ownership and participation in the economy. This meant that the AIA distinction between national, and thus ASEAN investors on the one hand, and foreign investors on the other was significant, provided Philippine nationalistic sentiments were not also directed at investors from the other ASEAN countries.

2.4 Indonesia

The FDI regime in Indonesia was liberalised from 1985, albeit gradually to avoid arousing nationalistic sentiments over control by foreign interests of national economic resources. As in the Philippines, the Indonesian Constitution, specifically Article 33, mandates state control over key economic sectors (Borsuk, 1999: 144-47). Extensive liberalisation was introduced in 1994 in which the divestment clause requiring foreign equity to be reduced to below 50 per cent within 15 years was eliminated, although with certain conditions attached. Also, nine previously closed strategic sectors in services, industry, and utilities were opened to foreign investment through joint venture operations (Pangestu and Azis, 1994: 21). Full foreign ownership was permitted with few conditions attached while the minimum Indonesian national equity required for joint ventures was reduced to 5 per cent from 20 per cent (Negara, 1998: 12).

Furthermore, the IMF restructuring programme adopted as a result of the financial crisis removed all foreign investment restrictions in the wholesale and retail trade from March 1998, two sectors that had remained untouched by earlier deregulation packages (Soesastro and Basri, 1998: 24). Nevertheless, significant restrictions on land ownership remained, which restricted foreign corporations to owning only the buildings for a maximum period of 50 years (ASEAN Secretariat, 1998b: 100-101). Apart from this, the FDI regime in Indonesia was fairly liberal, making the AIA distinction between foreign and ASEAN investors somewhat irrelevant in the Indonesian case.

2.5 *Singapore and the other ASEAN countries*

Singapore maintained a liberal FDI regime, with virtually no restrictions on foreign ownership of Singapore corporations except for national security reasons and in certain industries like banking, shipping, airlines and the utilities. Brunei also maintained a relatively liberal FDI regime. The new members of ASEAN – Vietnam, Myanmar, Laos, and Cambodia – generally treated foreign investors better than national investors when offering incentives and in taxation (ASEAN Secretariat, 1998b: 48, 64), making the AIA distinction between ASEAN and foreign investors irrelevant. While their foreign equity policies were often far more liberal than those in the core ASEAN countries, these governments maintained fairly stringent restrictions on land ownership and leasing, while domestic borrowing was generally not permitted (ASEAN Secretariat, 1998b: 100-101). In

[20] Foreign firms establishing joint ventures with the National Development Council can own land.

these areas, the AIA clause with regard to foreign versus ASEAN investors was, therefore, significant.

2.6 National FDI Regimes and the Foreign-ASEAN Distinction in the AIA

The above survey of FDI regimes in the core ASEAN countries reveals that foreign investors faced particular restrictions when investing in these countries despite the overall liberal FDI climate. These restrictions ranged from equity ownership conditions, market access to certain sectors, land ownership regulations and access to domestic sources of finance, although the restrictions were not identical across the different countries. These restrictions made the AIA offer of national treatment and market access to ASEAN investors ahead of foreign investors significant indeed.

The further liberalisation of FDI regimes in the manufacturing sector, particularly in Thailand and Indonesia, as a result of the financial crisis somewhat weakened the distinction between foreign and national/ASEAN investors although it did not completely remove it. Malaysia's crisis-driven liberalisation was undertaken on a temporary basis, indicating that the foreign-national distinction in investment remained crucial. For the core ASEAN countries, the AIA distinction between ASEAN and foreign investors appears to be most relevant in the category, services 'incidental' to manufacturing, forestry, agriculture, mining, and fisheries, although market access and national treatment privileges to ASEAN investors in these sectors were only to be accorded from 2010.

The very fact that the ASEAN governments chose to emphasise the distinction between ASEAN and foreign investors in the AIA is itself significant, irrespective of later developments in FDI regimes and in implementation. It is this that requires explanation, given that AFTA had become a key instrument to direct global investment capital to the

ASEAN region. This chapter suggests that the answer lies in the way certain governments in ASEAN interpreted particular global developments in terms of their impact on the future of domestic capital, especially those segments of domestic capital that had close ties to the political elite and were important in sustaining elite rule. The rest of the chapter elaborates on these arguments.

3. Multilateral Trade Rules and ASEAN Interpretations of Globalisation

Aside from the pressures generated by the increasing mobility and changing patterns of global FDI flows, globalisation also manifested itself during the 1990s through the structural changes that were taking place in the multilateral trading system. As discussed in Chapter 1, the 1990s witnessed the growing emphasis placed by advanced country governments on negotiating multilateral rules to govern 'beyond the border' barriers to free trade, which had the potential to markedly weaken the discretionary authority of governments on key aspects of domestic policy (Smythe, 2000: 75). Moreover, these developments were not merely taking place at the WTO, they were also being considered in regional forums such as APEC and the OECD, especially in the area of investment rules.

3.1 Multilateral rules: creating a level playing field for foreign/global corporations

The Uruguay Round agreements, and since then the WTO, had significant implications for FDI, although no explicit set of rules governing FDI *per se* has so far been adopted. While the TRIMS Agreement was limited to regulating investment measures that had trade effects, the General Agreement on Trade in Services (GATS) brought the issue of market access and national treatment for foreign investors to the forefront of global trade negotiations (Gibbs, 1997: 189). The national treatment principle was, however, watered down substantially in the GATS due to strong objections from developing country governments (WTO Secretariat, 1999). WTO members were, nevertheless, expected to reconsider the issue during the new round of trade negotiations scheduled for 2000 as well as the possibility of including investment under WTO rules.[21]

While the TRIMS did not sanction the right of foreign firms to market access and national treatment, it was clear that global TNCs were interested in just such guarantees (Sell, 2000: 179-80). TNCs from the industrial world were increasingly keen on developing global rules that would maximise their freedom of operation globally (Smythe, 2000: 72). Industrial country governments, led by the US, backed these demands and, in 1991, instructed the OECD to begin discussions on a more comprehensive investment regime that also included the national treatment principle. The US had turned to the OECD because of the difficulties that had been encountered in negotiating the TRIMS agreement at the GATT (Smythe, 2000: 78-79). The target, nevertheless, was to develop a new global regime in which non-OECD members would participate, since it was in the non-OECD countries that foreign corporations faced the most restrictions when investing.

The OECD began formal negotiations on a multilateral agreement on investment (MAI) in 1995, which was to be open to accession by non-OECD countries. The MAI advocated national treatment, the right of entry and establishment of foreign investment, the right to full equity ownership, as well as national treatment rights in privatisation (Khor, 2001: 86-87). The EU countries in particular wanted the MAI to eventually migrate to the WTO to enable trade leverage to be used in disciplining governments and resolving disputes over the free movement of investment (Smythe, 2000: 80). Although the MAI was eventually shelved in 1998 due to disagreements among OECD members as well as strong opposition from non-governmental groups representing labour and the environment, it generated

[21] *FEER*, 'The heat is on', 21 May 1998.

enormous controversy in the developing world, including in ASEAN. The MAI episode clearly revealed to ASEAN policymakers the rising interest among industrial country governments and global corporations in introducing global rules to guarantee the free movement of investment in the world economy.[22]

The investment issue was also pursued in APEC, though with only partial success. Although the grouping's developing country members were opposed to adopting a binding trade and investment liberalisation agreement, the United States, backed by Canada, Australia and New Zealand, succeeded in getting APEC members to adopt a set of investment principles that included national treatment. Developing country member governments, however, ensured that the investment code was non-binding on members (APEC, 1994). Importantly for the argument developed in this dissertation, this episode signalled to the ASEAN countries the keen interest of industrial country governments and the TNCs in negotiating global investment rules.

Although investment was kept firmly off the negotiating agenda in the WTO by a group of developing countries, led by India and Brazil and including Malaysia and Indonesia, it was not certain that this state of affairs would continue. WTO members had agreed as a compromise to study the issue further and had set up a working group on investment in 1996. Its brief was not only to study the trade-investment nexus more carefully it was also to assess the feasibility of incorporating investment into the WTO. Many governments regarded the reprieve as only temporary, particularly since the WTO was scheduled to review and re-negotiate the TRIMS in 2000 (Sell, 2000: 182). The expectation was that it was only a matter of time before such guarantees to foreign investors were written into the

[22] Interview via e-mail with Mr Ong Hong Cheong, retired senior analyst in the Bureau of International Economics, Institute of Strategic and International Studies (ISIS), Malaysia, May

WTO regime.[23] These expectations were not misplaced.[24] In 1998, the WTO General Council decided that the Working Group on Investment should continue its work until the Seattle ministerial meeting in 2000 when members would decide on whether to incorporate investment within the WTO.[25] The European Commission was particularly interested in ensuring that the national treatment principle formed a key part of any future WTO regime on investment (Khor, 2001: 87).[26] The issue of investment rules was clearly a lasting concern, with global firms and their parent governments continuing to sustain the issue.

3.2 The ASEAN Position and Response

Most of the ASEAN countries rejected the idea of a global regime for investment when it first became clear in the early and mid-1990s that many industrial country governments were considering such a project.[27] Malaysia especially was opposed to the notion of national treatment. Trade minister Rafidah Aziz rejected the demand for

> "free movement of investment across national borders and for national treatment, ... [which] will remove the right of national governments to implement national level investment policies which may either restrict a foreign presence in certain sectors, or which may provide preferential treatment to national firms to enable them to grow and be able to compete with large established foreign firms".[28]

Indonesia also formally outlined its objections to the inclusion of investment in the WTO by jointly submitting a petition together with Malaysia and six other developing countries on the matter.[29]

2001.
[23] Khor (2001: 86).
[24] Also see *Business Times*, 'A multilateral investment pact?' 1 February 1996.
[25] From the *Report of the WTO General Council Meeting 1998*. See WTO (1998). All reports and minutes of General Council meetings are available at the WTO website (www.wto.org). The Seattle Ministerial was abandoned due to disruptions by anti-globalisation protestors.
[26] Also see *The Nation*, 'Global battle on trade continues 50 years later', 18 May 1998.
[27] *Business Times*, 'Lengthy agenda for ASEAN meet', 10 September 1996.
[28] *Business Times*, 'Malaysia against restrictive investment rules: Rafidah', 10 July 1996.
[29] *Business Times*, 'Malaysia, seven others jointly oppose new WTO rules', 5 November 1996.

Thailand initially rejected the idea of a global investment agreement.[30] After the financial crisis, however, the Thai Cabinet agreed to support the adoption of a broad trade and investment agreement at the WTO Ministerial Meeting in Seattle, provided issues like investment incentives, dispute settlement between governments and private business, and national treatment principles were excluded.[31] Although Thai support was for a more limited agreement, compared to the more comprehensive MAI, the government was, no doubt, responding to the country's need to remain attractive to FDI in the face of loss of investor confidence in Thailand. Singapore was more sympathetic to the idea of a global investment regime.[32]

Although practically all the core ASEAN countries rejected the idea of a global investment regime that would include the principle of national treatment, the concerns were strongest in Indonesia and especially Malaysia as already noted, and were centred on the future of domestic firms.[33] These concerns were reflected in the presence of a parallel discourse in these countries that interpreted globalisation in a somewhat different way from that in the competitiveness discourse although it did not entirely reject the notion of competitiveness.

3.3 Interpretations of Globalisation and Competitiveness

Although for the most part globalisation was interpreted in a positive manner in ASEAN, as a process through which national economies could participate in global wealth creating activities that would benefit national society, other interpretations and discourses were also evident. The primary discourse, emphasising competitiveness, continued to focus on

[30] *Business Times*, 'Thais not ready for EU pact', 12 March 1996.
[31] *The Nation*, 'Cabinet to set stance on WTO issues', 20 November 1999.
[32] See footnote 30.
[33] Ong Hong Cheong confirms this point in the case of Malaysia.

the importance of adopting neoliberal economic reforms in order to adjust to globalisation (Soesastro, 1998). In Malaysia and Indonesia, a parallel, sometimes competing, discourse was also present that deviated from the neoliberal competitiveness/globalisation discourse in that it focused on the possible demise of domestic firms as a result of having to compete with well established foreign TNCs. The competing discourse became especially pronounced during the time of the debates and moves in the OECD, the EU and the WTO to inscribe global investment rules.

Competing discourses of globalisation and competitiveness: Malaysia and Indonesia

While the competing discourse on globalisation in Malaysia and Indonesia did not reject the idea of competitiveness *per se*, it stressed another means by which competitiveness could be achieved. Notably, it focused on the key role of governments in nurturing domestic firms through preferential policies as a means of enabling them to develop into firms capable of competing with the larger TNCs in the global market. It thus reflected developmental ideas.

In Malaysia, Dr Mahathir, the Prime Minister, had largely shaped discourses on globalisation, which by the mid-1990s had become a common part of the Malaysian political and economic scene (Welsh, 1999: 272). The centralisation of power in the office of the Prime Minister coupled with the personal authority that he largely enjoyed, at least until the financial crisis, meant that his ideas and interpretations generally prevailed and were translated into official policy. What was most notable about Malaysian discourses on globalisation was the embrace of only parts of the globalisation message associated with the Washington Consensus.[34] Other aspects were redefined or re-interpreted, again largely by the Prime Minister, while ideas pertaining to liberal notions of politics that were advocated by western governments, especially the US, were rejected.

In the Vision 2020 document of 1990, which laid the foundation of the Prime Minister's attitudes and responses to globalisation and his strategies to achieve developed country status for Malaysia, the neoliberal message of markets, competition and competitiveness was explicit. Mahathir's aim was to "secure the establishment of a competitive economy ... that is subjected to the full discipline and rigour of market forces" (Mahathir, 1990: 3). The Prime Minister also appeared to accept the nature of global market competition when he commented that "entry into the world market pits our companies against all comers and subjects them to the full force of international competition...a challenge we must accept ..." (Mahathir, 1990: 9). As already noted, the adoption of policies of deregulation, privatisation and liberalisation in Malaysia were consistent with these ideas and interpretations.

Despite the emphasis on competitiveness, other concerns were never ignored, only de-emphasised. By 1996, however, the Prime Minister's long-held concerns about the inequalities in the global economy re-surfaced in the discourses associated with globalisation. The timing of his re-interpretation of globalisation, even before the financial crisis hit Malaysia, was linked to the flurry of activity at the OECD on the MAI, the move to embrace new issues in the WTO, and the pressure on Malaysia to make better market opening offers in the GATS financial services negotiations. At the Sixth G-15 Summit in Harare in November 1996, the Prime Minister pointed out that "in the name of

[34] The Washington Consensus refers to a set of orthodox economic ideas that advocate, among other things, trade and investment liberalisation, deregulation as well as privatisation as a way to

globalisation, developing countries have been called upon to account for many things, be it the environment, labour standards, investment laws, financial services, or other development issues".[35] Mahathir also began enunciating the view that globalisation was a threat to developing countries in general, and their firms in particular.[36] This interpretation became increasingly pronounced since the 1997 financial crisis. The competing discourse also drew attention to the emergence of huge corporations and banks that dominated economies everywhere through having acquired or absorbed small companies and banks, particularly in the developing world (Mahathir, 1998: 111). The concern with growth through embracing neoliberal policies was, from the mid-1990s, also confronted by the concern with building up domestic firms.

In Indonesia, three competing discourses were evident during the 1990s. All three shared the same perception of globalisation as an inevitable economic force, which Indonesia needed to cope with or "survive" (Rinakit and Soesastro, 1998: 193). These three discourses, nevertheless, viewed competitiveness and how to achieve it through different lenses. Although neoliberal ideas about competitiveness appeared to be dominant, seemingly reflected in the trade and investment liberalisation undertaken during the mid-1990s, neoliberal policies were essentially limited to the external sector. Reforms to deregulate the domestic economy, increase market competition and privatise state enterprises were far more limited, reflecting not only the particularistic interests of the politically well-connected but also competing concerns in Indonesia with nurturing domestic capital.

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achieving competitiveness and maximising economic welfare (Williamson, 1994).

[35] Speech to the Inaugural Plenary of the Sixth G-15 Summit made on behalf of the Asian members of the G-15, in Harare, Zimbabwe on 3 November 1996. Available on the website of the Prime Minister's Department, Malaysia (www.smpke.jpm.my).

[36] Mahathir's speech on 'Globalisation – what it means to small nations', quoted in Welsh (1999: 273).

The discourse of the economic nationalists emphasised the importance of economic reform to meet the competitive challenges of globalisation, but advocated state intervention to protect strategic industries and sectors from foreign domination and for governments to help leapfrog technological development (Murphy, 1999: 235). Minister of Research and Technology, B.J. Habibie, later Suharto's Vice-President in 1998 and subsequently Indonesian President for a year until late 1999, was the most prominent proponent of these ideas. These ideas resonated with many Indonesians, who regarded a state-controlled economic system to be sacrosanct under the country's Constitution (Rinakit and Soesastro, 1998: 196). Moreover, the nationalists were also concerned with the dominance of the Indonesian economy by ethnic Chinese Indonesian business (Borsuk, 1999: 142).

The discourse of the economic populists, like that of the liberals and the nationalists also emphasised economic restructuring, but the populists saw a crucial role for the state in nurturing small and medium-scale, indigenous businesses and the rural economy, rather than large, strategic industries. Like the nationalists, the populists, the most notable of whom was Adi Sasono of the Muslim Intellectuals Association, were also concerned by the dominant position of ethnic Chinese Indonesian capital, which the populists believed had thrived under the liberal economic policies of the government (Murphy, 1999: 235). Thus, the populists were in favour of an affirmative action programme similar to that in Malaysia to upgrade the economic position of the majority indigenous population (Murphy, 1999: 247).

Although the conventional wisdom in the literature is that neoliberal policies were adopted in Indonesia due to the dominant position in the bureaucracy and government of liberal technocrats,[37] this became less salient as the 1990s wore on. By 1994, President Suharto had appointed many economic nationalists to his cabinet, until then dominated by liberal technocrats (Borsuk, 1999: 140-43). As Section 4 below shows, policymakers increasingly embraced the idea that deregulation and liberalisation could be strategically integrated with state-driven industrial policy to help develop domestic industrial and commercial capabilities (Robison, 1997: 53). The concern with nurturing domestic capital was clearly reflected in these discourses, and ultimately in policy.

Thailand and the Philippines

Although competing discourses of globalisation challenging its purported beneficial effects were present in Thailand and the Philippines, constructed largely by non-governmental organisations, the powerful liberal technocrats in these respective governments continued to emphasise a conventional neoliberal policy agenda of growth and international competitiveness (Chantana, 1998: 271-4; Gochoco-Bautista, 1998: 222). In both countries, the technocrats were supported by outward-oriented big business, especially in Thailand. In the Philippines, the neoliberal economic agenda was supported by the significant constituency that had emerged by the 1990s that advocated economic reform in order to challenge the power of the old landed oligarchy (Hutchison, 1997). Nevertheless, departures from neoliberal policies, including in AFTA, were not uncommon in the Philippines, driven by particularistic business interests with substantial political influence. Departures from liberal economic policies and from AFTA were less evident in Thailand, due to the powerful coalition of interests – technocrats and urban-based big business – in favour of the neoliberal agenda (Krongkaew, 1997: 33-35).

[37] This is Stubbs' argument (Stubbs, 2000).

4. Using the AIA to Help Domestic Capital Face Global Market Competition

The ASEAN countries sought to respond to the potential changes in the multilateral trading system in two ways. One was to jointly accelerate liberalisation in services and investment ahead of the WTO as a way of further distinguishing AFTA from other potential sites as a region of investment and production in both the manufacturing and services sectors. The ASEAN governments were, thus, engaged in a continuous game to differentiate the ASEAN/AFTA regional market in an environment where investment sites were seemingly becoming identical at the policy level.

The second response of governments to developments at the multilateral level, especially in Malaysia and Indonesia, was to advocate the provision of preferential investment treatment for ASEAN firms in the AFTA regional market. The idea was to nurture domestic capital to enable it to meet global competition eventually, particularly before multilateral rules required the full opening up of national economies to foreign firms. The AIA component of AFTA offered just such an opportunity, without necessarily jeopardising the role of the CEPT component in attracting FDI. These governments were, therefore, sufficiently realistic not to adopt inward-looking policies that restricted or rejected FDI, with both governments remaining committed to FDI and to open regionalism in the CEPT.

Thus, Article 3 of the AIA lists as one of its objectives, "increasing the flow of investments into ASEAN from *both* ASEAN and non-ASEAN sources" (ASEAN, 1998d).[38] This was related to the more urgent goal of encouraging the development of ASEAN conglomerates through joint ventures or other forms of alliances between ASEAN investors. A senior Malaysian trade official acknowledged that the AIA was designed not only to increase the inflow of FDI into the region it was also aimed at "developing and helping ASEAN investors".[39] A senior official from the ASEAN Secretariat explained that "the ASEAN countries saw the need to develop regional MNCs using the grace period before foreign (non-ASEAN) investors would be accorded the same privileges".[40] In other words, the AIA incorporated developmental features in its design of regionalism.

4.1 The Lure of Large Domestic Firms and ASEAN Multinationals

During the three years of discussions and consultations on the AIA, the issue of whether to accord preferential treatment to ASEAN investors over all other foreign investors emerged as a key point of discussion. At these meetings, the point was made that privileging ASEAN investors would be difficult to justify on economic grounds, since foreign TNCs possessed the strategic assets that the ASEAN countries required in order to participate in increasingly sophisticated global production (Chia, 1996: 20). Nevertheless, it was also acknowledged that preferential treatment of ASEAN investors could stimulate intra-ASEAN investments and facilitate the emergence and growth of indigenous ASEAN multinationals, which were necessary "to compete in a world economy increasingly characterised by globalisation and competition" (Chia, 1996: 21).[41]

ASEAN leaders and policymakers were broadly united on the importance of domestic firms becoming large and/or multinational as a means of meeting global market

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[38] Author's emphasis.
[39] Interview with Mr Razak Ramli in Malaysia, August 2000.
[40] Interview with Dr Wee Kee Hwee of the ASEAN Secretariat.
[41] It should be noted that a joint-venture firm involving both domestic/ASEAN and foreign equity would be entitled to the AIA privileges accorded to an 'ASEAN' investor if its equity structure allowed it to be categorised as a domestic investor by the laws of the host country. This rather flexible principle was meant to encourage joint ventures between domestic and foreign firms that would, it was hoped, stimulate technology transfer between the foreign and domestic firm. Discussion with Dr Suthad Setboonsang, then ASEAN Deputy Secretary General.

competition. The Singapore government's 'Local Enterprises 2000' strategy, first enunciated in the country's 1991 Strategic Economic Plan, proposed to groom a group of promising local enterprises over the next ten years to become the MNCs of the future (Wong and Ng, 1997: 136). Singapore Senior Minister Lee Kuan Yew, noting the intense competition that ASEAN firms were facing from global firms, also suggested strategic partnerships as a means to face such competition.[42] President Suharto advocated large and medium-sized firms for Indonesia for similar reasons.[43] On the one hand, this may well reflect Suharto's need to justify the regime's preferential treatment of the conglomerates of his ethnic Chinese allies and family members. On the other hand, Suharto was supportive of his Research and Technology Minister, B.J. Habibie's plans to develop large, technologically advanced firms as a means for Indonesia to leap-frog technology development and join the ranks of the advanced industrial economies (Mardjana, 1999: 51). The private sector also echoed these sentiments. The President of the ASEAN Business Forum agreed that "we are too small to go out and fight with the Fortune 500 companies",[44] while the Thai private sector urged its government to support the creation of regional Thai firms.[45]

4.2 Malaysia: The Main Proponent

Malaysia was especially vocal in advocating large enterprises as a means of facing global competition, emphasising in particular the idea that ASEAN multinationals or conglomerates would be best able to weather global market competition rather than smaller firms. It was the Prime Minister's belief that only products from large firms would

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[42] *Straits Times*, 9 October 1996.
[43] *Bulletin KADIN Indonesia* . (Bulletin of the Indonesian Chamber of Commerce and Industry), No. 11/XIII, 30 September 1995.
[44] *Business Times*, 'ASEAN firms urged to tap potential in region', 19 March 1997.
[45] *The Nation*, 'Regionalism scope needed under AFTA', 21 August 1997.

be able to penetrate the world market.[46] Thus, Mahathir advocated using the state to assist "small and medium industries ... to grow bigger", for all Malaysian firms to become "sturdy and strong" and be able to "take on the world" (Khoo, 1995: 330).

Comments since the early 1990s by senior officials of the Economic Planning Unit, the foremost economic policymaking agency in the country, revealed the growing emphasis placed on nurturing domestic capital and the extent of official discomfort with the country's overwhelming reliance on FDI. A senior official from the Unit noted that "FDI cannot be relied upon to build up an indigenous base, which is required for long-term sustainable industrialisation ... building up indigenous industries, owned and controlled by Malaysians is more complex but is more important in the long run".[47] The head of the Unit in 1992 explained that the thrust of economic policy over the next few decades would be "the creation of Malaysia's own multinationals and global companies" (Ali, 1992). Thus, it was not surprising to find that Malaysia was the main advocate of the clause in the AIA offering ASEAN investors market access and national treatment privileges ahead of foreign investors.[48]

The Malaysian government saw the AIA as an opportunity for national companies to grow and develop their industrial and commercial capabilities by exploiting the investment privileges the investment agreement would accord them in the regional market compared to foreign investors.[49] Trade minister, Rafidah Aziz advocated regional level mergers and acknowledged that discussions had been held among ASEAN policymakers on how to

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[46] *Business Times*, 'Only large enterprises can compete globally', 29 April 1997.
[47] Comment by Abdullah Tahir, quoted in Felker (1998: 247).
[48] Interview with Mr Karun Kittisataporn, Director-General of the Business Economics Department, Ministry of Commerce, Thailand in August 2000.
[49] See the comment by a senior Malaysian investment official in *Business Times*, 'Don't ask for many exemptions, industries told', 26 March 1999.

encourage national firms to form large ASEAN conglomerates to exploit regional market opportunities as well as to compete effectively in the global market, including in service sectors.[50] Rafidah also suggested the possibility of an ASEAN financing mechanism, such as a Pan-ASEAN Export-Import (EXIM) Bank to provide financial backing for ASEAN conglomerates in their regional operations.[51] Of the other core ASEAN countries, only the Indonesian government explicitly supported the Malaysian position. In October 1998, Coordinating Minister for the Economy, Ginandjar Kartasasmita endorsed the Malaysian suggestion of using the AIA to develop ASEAN multinationals and conglomerates that would be globally competitive.[52]

Although policymakers in Thailand found the privileging of ASEAN investors in the AIA to be contradictory to AFTA's role as an instrument to attract FDI to ASEAN,[53] neither Thailand nor Singapore rejected the Malaysian suggestion.[54] There were no disputes in ASEAN over the AIA, unlike the very vocal and public disputes over petrochemicals, agriculture and automobiles. The regional financial crisis, however, drew attention to the contradictions inherent in AFTA between privileging ASEAN investors and attracting foreign investors from outside the ASEAN region. The ASEAN Secretary General was somewhat critical of the distinction the AIA made between ASEAN and non-ASEAN investors in view of the urgent need to boost FDI flows to the region as a result of the financial crisis.[55] A senior Thai investment official also expected the crisis to force the ASEAN governments to play down the intra-region investment area and focus on

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[50] *New Straits* Times, 'Set up ASEAN consortiums, urges Rafidah', 13 March 1997; and Business *Times*, 'Bumi economic shares won't fall', 11 April 1998.
[51] *Business Times*, 'ASEAN to boost liberalisation, address dwindling FDI', 10 October 1998.
[52] *Bisnis Indonesia* (Indonesian Business), 10 October 1998.
[53] Interview with Mr Karun Kittisataporn of Thailand.
[54] Follow-up interview with Ms Lim Bee Suan of the Singapore Trade Development Board, conducted via e-mail in June 2001.
[55] *Business Times*, 'ASEAN cuts deeper into trade, investment barriers', 8 March 1993.

strategies to attract FDI from outside the ASEAN region.[56] Nevertheless, the distinction in the AIA between ASEAN and foreign investors remains at the time of writing. Moreover, even if the distinction were temporarily shelved or eventually removed, the fact that this form of regionalism was even contemplated requires explanation.

5. Domestic Capital in the Domestic Political Economy of the ASEAN Countries

Malaysian and Indonesian responses to the AIA, specifically the privileging of domestic/ASEAN investors, lay in the key role played by domestic capital in these societies, particularly their political role. Although Thailand and Singapore did not actively champion such a clause in the AIA, the absence of any challenge from these countries on the issue needs to be explained. As the following discussion shows, the Malaysian move to privilege ASEAN investors in the AIA did not contradict the aim of the Singaporean and Thai governments to create the conditions for Singaporean and Thai domestic capital to expand through the regional market. These two cases will be dealt with first before examining the Malaysian and Indonesian cases.[57]

5.1 Singapore: Economic Restructuring, Domestic Capital and Regionalisation

The mid-1980s recession led the Singapore government to recognise the vulnerability of the island economy to global economic upheavals as a result of its over-reliance on FDI, manufacturing production, and exports to developed markets as well as the lack of indigenous entrepreneurs (Yeung, 1999: 7). This led to the adoption of a new growth strategy that emphasised services as a vital growth sector, the expansion of domestic capital, and regionalisation (Rodan, 1993: 229). While FDI remained important, the

[56] *Bangkok Post*, 'Region's ministers reaffirm plan', 6 March 1999.
[57] The Philippine case will not be presented. The overwhelming concern in this country during this period was whether Philippine business would be able to survive the CEPT and the influx of more competitive imports from the ASEAN region.

expansion of domestic capital was regarded as crucial for Singapore's competitiveness (Yeung, 1999: 8) and as a way to reduce the over-reliance of the economy on external capital (Singapore, 1993: 3). Regionalisation was aimed at "geographically expand[ing] the Singapore economy itself" (Rodan, 1993: 225). The regionalisation strategy not only emphasised Singapore's role as a springboard for global TNCs locating in Singapore to operate in the region, it was also regarded as a means of enabling domestic capital to expand beyond the confines of the limited domestic market (Parsonage, 1994: 1-4; Yeung, 1999: 8).

The novel feature about the new growth strategy was the commitment to facilitate the expansion of domestic private capital, which was a turnaround for the PAP government that had governed Singapore since the early 1960s. Singapore's development strategy in the past had relied heavily on FDI, driven by the PAP government's historical distrust of the predominantly ethnic Chinese domestic capital. The animosity between the PAP and Chinese business stemmed from the latter's perceived support for 'Chinese chauvinism' and left-wing/communist political elements within the PAP during the party's factional struggle during the turbulent 1960s (Turnbull, 1989). The bias towards foreign capital in development was compounded by the government's belief that domestic private capital lacked the capability to engage in efficient production (Parsonage, 1994: 10). Moreover, state capital had taken on the role of domestic private capital, engaging in a range of activities in services, heavy industry and high technology activities through government-linked corporations (GLCs) (Wong and Ng, 1997: 124).

After the 1985 recession, the nurturing of domestic private capital, including the building up of large domestic corporations, became a priority for the government although it did not envisage the development of domestic private capital through protectionism. Instead, the government's approach was to supply the necessary public goods like human resources, research and development facilities, and information, as well as fiscal and financial incentives to support domestic capital in market competition (Singapore, 1991). The regionalisation drive – Regionalisation 2000 – was a key element in creating the conditions to enable the expansion of domestic capital. Domestic firms were seen as natural suppliers and joint venture partners to the GLCs, which had already begun diversifying their operations to the ASEAN region (Rodan, 1997: 160). The concentration of domestic private firms in the now critical service sector, particularly in finance and commerce, reinforced the role of domestic capital in Singapore's future growth. Although domestic private capital in finance and manufacturing was already investing abroad since the late 1980s, largely in the ASEAN region (Yeung, 1999: 12), 'Regionalisation 2000' was an effort to actively encourage and hasten the process. Singapore Prime Minister Goh Chok Tong emphasised that "going regional is part of our long-term strategy to stay ahead. It is to make our national economy bigger, our companies stronger and some of them multinationals".[58]

Moreover, the service sector, emphasised as the new growth sector for the economy, was heavily reliant on the regional market, which made services inextricably linked to the regionalisation strategy. The competitive advantage of Singapore service firms also lay in the regional market (Dicken and Yeung, 1999: 119). Lacking the necessary ownership-specific advantages to compete with global TNCs in global markets, local service firms were not keen to venture further afield. This explains why Singapore was keenest among the ASEAN countries to negotiate services liberalisation within AFTA[59]. The government's recognition of the trend towards unbundling and outsourcing of previously

[58] Reproduced in *Speeches*, May-June 1993: 15.
[59] Interview with Mr Rodolfo Severino Jr, Secretary General of ASEAN.

in-house services such as logistics and information technology services in manufacturing industry (Singapore, 1998: 38) also explains its desire to include services 'incidental' to manufacturing and other economic sectors in the AIA.[60] The regionalisation drive required an active regional diplomacy to negotiate the institutional framework necessary to facilitate the expansion of domestic capital. The Singapore government's support and championing of AFTA, thus, needs also to be seen in this light, and not solely because of AFTA's role in attracting FDI.

The regionalisation drive also brought political benefits to the ruling government. As already noted in Chapter 3, economic growth was a key component of political legitimacy for the PAP government. The regionalisation strategy allowed the PAP government to regenerate the bases of its domestic legitimacy by incorporating domestic capital as a source of growth. It allowed the PAP government to co-opt the only remaining group – domestic Chinese business – capable of mounting an independent challenge to the PAP government (Minchin, 1986). Nevertheless, the dominant governing elite in Singapore remained the alliance of political, essentially PAP elites and bureaucratic elites together with state capital. Domestic private capital occupied the position of junior partner despite its centrality to Singapore's new development strategy, since it relied on government incentives and assistance for restructuring and regionalisation.

The discussion suggests that the privileging of ASEAN investors in the AIA did not contradict the interests of the Singapore government. In fact, it benefited Singapore's economic restructuring strategy based on the expansion of domestic capital through regionalisation. Although the regional financial crisis prompted a re-think of the regionalisation strategy, with Singapore opting for a more global strategy to diversify risk

[60] Interview with Dr Wee Kee Hwee of the ASEAN Secretariat.

and avoid 'putting all its eggs into the regional basket', regionalisation remains a key plank in Singapore's growth strategy for the future (Yeung, 1999: 9).

5.2 Thailand: Domestic Capital and Overseas Expansion

Thailand has always had a sizeable and active domestic business sector since the late 1950s (Unger, 1995: 78). Although Thailand experienced an FDI boom since 1985, foreign capital did not overwhelm domestic capital, which also expanded considerably after 1985 (Phongpaichit and Baker, 1995: 156). Most importantly, domestic capital, particularly urban big business, not only played a key part in the rapid economic growth experienced by Thailand in the late 1980s it also began to expand overseas.

Overseas expansion by outward-focussed elements of domestic capital, assisted by new tax incentives, the liberalisation of foreign exchange regulations and the advent of off-shore banking, was concentrated in forestry, property, telecommunications, finance, and manufacturing (Phongpaichit and Baker, 1995: 166). Domestic firms essentially used the expertise and resources generated through domestic activities to venture into overseas markets, including but not exclusively in the ASEAN region. Although this trend was evident in the manufacturing sector, it was especially notable in services where large family-based Thai conglomerates dominated (Phongpaichit and Baker, 1998: 28). The Shinawatra group, the Samart group, the Charoen Pokphand group and the Ucom group, for instance, ventured overseas to Southeast Asian markets in a variety of activities related to their core domestic business in telecommunications and information technology.

Unlike Singapore, Thailand did not have a formal policy to develop domestic capital or a formal regionalisation policy to support the overseas expansion of Thai private capital.[61] Nevertheless, the government's commitment to AFTA served the interests of the Bangkok-based business elite, which was in close alliance with the liberal technocrats in government who advocated open economic policies for Thailand, including regional trade liberalisation. The relationship between this globally oriented segment of domestic capital and the government was different from that in the past when business demands had served narrow, particularistic interests. In the 1990s, globally oriented Thai firms were more interested in getting the government to provide the necessary public goods – education, skills development and infrastructure – to keep pace with economic growth. Moreover, they also depended on the government to manage regional foreign relations in order to facilitate capital's expansion in the region (Phongpaichit and Baker, 1995: 168).

As in the case of Singapore, the importance of AFTA to Thailand should also been seen in this light, as a mechanism that also benefited the growth of domestic capital, especially the Bangkok-based business elite. Nevertheless, for the Thai government, the most important reason for establishing AFTA was to attract FDI.[62] Despite this, the privileging of ASEAN investors in the AIA did not necessarily contradict the interests of the state elite nor that of its business allies since the AIA did not jeopardise the workings of the CEPT, which was the primary instrument used to attract FDI to the region. More importantly, the AIA benefited Thai capital seeking to venture abroad.

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[61] Thai policymakers had never been entirely successful in directing industrial development through industrial policy, unlike in Malaysia or Singapore, due to the fragmentary state structure and faction-ridden politics in the country (Felker, 1998: 8).

[62] Interview with Mr Manasvi Srisodapol, Counsellor in the Department of ASEAN Affairs, Ministry of Foreign Affairs, Thailand in August 2000.

5.3 Indonesia: The Political Salience of Domestic Capital

The support given by Ginandjar Kartasasmita, Coordinating Minister for the Economy in the Habibie government, for the Malaysian proposal to use the AIA to nurture ASEAN firms and to develop ASEAN multinationals needs to be seen in the light of Ginandjar's credentials as an economic nationalist. The economic nationalists, discussed in a previous section, envisaged a key role for the state in directing markets to achieve particular national goals, particularly technological development and the nurturing of indigenous Indonesian capital. Dr Habibie and Ginandjar were both in favour of reducing Indonesian dependence on foreign technology (Djidin, 1997: 26). Habibie also justified his state-driven high-technology strategy in terms of enabling Indonesia to quickly move to higher valued-added production in the face of competition from cheap-labour economies like China and Vietnam (Brown, 1998: 200). Despite his broad commitment to neoliberal reforms, Suharto had been attracted to and generally supported Habibie's vision (Borsuk, 1999: 163; Liddle and Mallarangeng, 1997: 174).[63] Economic nationalist policies thus encompassed an economic imperative, emphasising growth though with a strong infant industry or strategic trade flavour, as well as a political agenda, namely the redistribution of economic wealth from non-indigenous to indigenous hands.[64] Ginandjar's response to the Malaysian proposal to employ the AIA to develop domestic capital, and President Habibie's support of it, need to be seen in this context.

Indonesian domestic capital may be divided into ethnic Chinese capital, indigenous or *pribumi* capital, and state capital, all of which were politically salient but for different reasons. The ethnic Chinese entrepreneurs dominated big business in Indonesia, having gained their economic fortunes and pre-eminent position in Indonesian business through

[63] This was unsurprising, as Suharto was rather ambivalent about the value of free markets, seeing them only in instrumental terms as a means to deliver regime-legitimating growth.

connections with politically influential persons, including military elites and especially President Suharto. Because of their Chinese ethnicity, they occupied a very vulnerable position in Indonesian society (Robison, 1996: 91). In return for political protection and economic benefits, the ethnic Chinese conglomerates provided funds to the President, which he disbursed to selected organisations and individuals in return for political support (Liddle, 1999: 51). The Chinese were, therefore, a crucial link in Indonesian patronage politics although they were strongly resented by indigenous Indonesian business interests,[65] the indigenous Indonesian public, the economic nationalists and the populists. The President and government were generally sensitive to anti-Chinese sentiment, which indigenous business exploited (Robison, 1996: 95). The government's support to both state and indigenous private capital needs to be seen against this background.

State-owned enterprises, some of which were part of the strategic industries programme initiated by Habibie, constituted a large part of the Indonesian economy during Suharto's rule, were only partially reformed through privatisation during the 1980s and 1990s,[66] and continue to remain salient in the post-Suharto era. The role of public enterprises as agents of development is legitimised by Article 33 of the Indonesian Constitution, which accords a primary role to state control of "branches of production essential to the state and governing the life and living of the public" (Mardjana, 1999: 41). Moreover, public enterprises were considered to be the "fortress for the indigenous", a bulwark against ethnic Chinese and foreign domination of the economy (Mardjana, 1999: 47). State enterprises were found in virtually all sectors, particularly infrastructure, finance, telecommunications, and high technology industries, the last under the purview of

[64] See Brown (1998: 188) on the redistribution imperative.
[65] The 1990s witnessed growing cooperation between the ethnic Chinese business elite and the indigenous business elite, although this was mostly limited to alliances between Chinese business and Suharto family businesses (Habir, 1999).

Habibie. Although strongly criticised by the technocrats, and even by indigenous business interests who feared their potential crowding out by state capital, Suharto generally supported the strategic industries programme as it reflected his vision of a developed Indonesia (Borsuk, 1999: 163).

As for private indigenous capital, Suharto also used economic favours like preferential credit and import licenses to encourage the growth of an indigenous business class during much of the 1970s and 1980s (Liddle, 1999: 52). These preferential policies enabled the President to ensure the political support of the indigenous elites[67] who were ultimately beholden to the President as a result of their special treatment (Liddle, 1999: 68). These policies continued into the 1990s despite the broad neoliberal reforms undertaken during this period. Indigenous capital was concentrated in sectors like power, roads, cement, telecommunications and broadcasting, banking and finance, and retail trade (Nallappan *et al*, 1998: 46). Interestingly, many of the indigenous business elites participated in politics but they did not confine their participation and support to the state party, Golkar and often worked with opposition parties as well (Robison, 1996: 93). Indigenous business was, therefore, a politically salient group that the President and government could not afford to ignore.

The political salience of indigenous and state capital did not, however, end with the fall of Suharto and the financial crisis. Many Indonesians, including economic nationalist policymakers, regarded further neoliberal reforms sanctioned by the IMF as attempts by western interests to impose a form of capitalism on Indonesia that would, once again, "prevent *pribumi* Indonesians from taking their rightful place at the economic table"

[66] See Mardjana (1999) for a comprehensive treatment of public enterprises.

(Habir, 1999: 202). The redistribution imperative to achieve economic parity between the ethnic Chinese and foreign investors on the one hand and indigenous groups, particularly in business, on the other, remained strong. Nevertheless, the financial and political crisis in Indonesia meant that the growth imperative, particularly attracting FDI to the country, became vital. Thus, the government supported the further acceleration of AFTA as a means to improve the investment climate in Indonesia, despite growing opposition to AFTA from domestic, particularly indigenous business interests.[68]

Nevertheless, Ginandjar's championing of indigenous business as well as his sensitivity to Habibie's strategic industries programme, possibly led him to view the AIA in the same way as Malaysia – a means to develop globally competitive domestic capital in an environment in which global market competition was inevitable.[69] AFTA could fulfil twin purposes – as an exercise in open regionalism to attract FDI and as an exercise in developmental regionalism. The latter supported the economic nationalist ideas of Ginandjar and his other allies, including Habibie, with regard to the nurturing of indigenous capital, but through regional cooperation rather than domestic policy.

Whether developmental regionalism through the AIA would be feasible as a means to help develop indigenous Indonesian capital and large-scale, high technology firms remains to be seen. Smaller indigenous businesses in Indonesia lack the capacity for overseas investment. Larger corporations would likely benefit, and this would include both indigenous and ethnic Chinese firms. There was also very little domestic discussion on

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[67] Small and medium-scale indigenous businesses also gained through patronage provided through the government political party, Golkar. See Robison (1996: 90-91).
[68] *Jakarta Post*, 10 October 1998; *Bisnis Indonesia*, 12 October 1998.
[69] It was, unfortunately, not possible to obtain direct confirmation of this argument through elite interviews. Government officials, in particular, were careful not to comment on nationalist thinking

Ginandjar's support for the Malaysian idea, which was rather unusual for Indonesia's vibrant press that usually provided extensive coverage of AFTA issues. It was very likely that this was because other more interesting political developments were unfolding daily in the country. It also suggests that the idea may not have been thought through carefully. Nevertheless, it clearly fits in with nationalist thinking and programmes, and Indonesia's support for Malaysia's developmental approach to the AIA should be understood within this context.

5.4 Malaysia: Ethnic Politics, Economic Nationalism and Domestic Capital

The political salience of domestic capital in Malaysia is tied up with the country's ethnic politics and with the broader economic nationalism of Prime Minister Mahathir. The original ethnic Malay capitalist project of the 1970s and 1980s soon became bound up during the late 1980s and 1990s with a broader Malaysian economic nationalism that sought to develop a more encompassing Malaysian capitalist class that would lead towards parity with the developed countries (Khoo, 2000: 214). Thus, the Malaysian government's approach to the AIA, as a means to develop domestic capital through stimulating their regional expansion on preferential terms, needs to be viewed against these dynamics in the domestic political economy.

Between 1970 and 1990, a state-directed development programme – the New Economic Policy (NEP) – drove the Malaysian political economy. The NEP was the outcome of ethnic riots following the May 1969 elections caused by Malay concerns at the community's economic marginalisation and fears that they would lose their political dominance to the relatively better off ethnic Chinese community as a result. Among the

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in economic policy in view of possible negative fallout, both from ethnic Chinese and foreign investors, both of which continue to be vital for growth in crisis-torn Indonesia.

policy's objectives was the creation of a Malay business (and middle) class and the achievement of a target of 30 per cent Malay equity in the corporate sector (Tori, 1997: 212). The NEP was vital to the legitimacy and security of the UMNO-dominated regime, since it enabled both a more equitable distribution of wealth for the Malays as well as Malay political dominance through control of economic resources. UMNO has long been the leading Malay party in Malaysia, regarded as the champion of Malay political rights in multiethnic Malaysia.[70] Although the NEP was replaced by the National Development Policy in 1991 that scaled back ethnic preferences somewhat (Stafford, 1997:569-76), the goal of creating a Malay business community continued to be emphasised in the 1990s (Tori, 1997: 236).

Even the privatisation programme undertaken as part of the economic restructuring package adopted in response to the mid-1980s recession was actively used to create a Malay business class to fulfil the NEP goal (Crouch 1996: 39). Although privatisation benefited largely UMNO-linked Malay businessmen, a limited number of ethnic Chinese and Indian individuals aligned with the ruling elite also benefited. In turn, these new rich business personalities who had emerged through patronage provided political leaders with access to large amounts of funds that could be used in party and parliamentary elections (Gomez, 1996). It also provided key political personalities, including but not only the Prime Minister, with their respective support bases drawn from among the new business elite (Gomez and Jomo, 1997: 117-65). By the 1990s, a politically influential rentier business community had become part of the governing elite, while political power became increasingly concentrated in the political executive, notably the Prime Minister (Khoo,

[70] Since the 1997 financial crisis and the sacking of then Deputy Prime Minister Anwar Ibrahim, Malay support for UMNO has declined, channelled instead to the opposition Islamic party and to the new party begun by Anwar's supporters.

2000: 221). The alliance between the political elite and rentier business was, thus, a crucial component in the Malaysian political economy.

The new Malaysian conglomerates that emerged out of privatisation and other preferential policies were also a key component of Dr Mahathir's wider economic nationalism. Especially after the mid-1980s recession, policy had moved beyond the NEP's narrow focus on building a Malay capitalist class to advocate the growth of large, Malaysian firms as a means of meeting the competitive challenges of the global economy (Khoo, 2000: 216). The policy shift reflected the strategic vision of the Prime Minister, who was no longer content with Malaysia remaining a Third World producer of industrial commodities. Thus, he stressed the building up of Malaysian corporations and conglomerates able to compete with foreign TNCs in what was perceived to be an intensely competitive world economy.

Many of these new conglomerates were mostly in the service sectors including infrastructure, finance and telecommunications in which many restrictions on foreign capital remained as well as in new import-substitution activities such as those linked to the national car project (Gomez and Jomo, 1997). Foreign firms were, however, dominant in the far more efficient, export-oriented manufacturing sector, which operated under a relatively liberal trade and investment regime. Success in the essentially protected sectors was less dependent on firms' international competitiveness and indigenous technological capabilities, and more on restrictions on entry as well as their access to preferential treatment through political connections (Khoo, 2000: 218). Nevertheless, the Prime Minister used the state to create and nurture these domestic firms with the ultimate goal being to enable their participation in global markets.

A former coordinator of Malaysian participation in OECD workshops, Mr. Ong Hong Cheong, notes that foreign interest in "national treatment [of investment] was seen by both the Malaysian government and the private sector to pose the biggest threat to domestic companies".[71] Ong points out that an

> "alarming aspect of the MAI was the open-ended definition of investment, because it meant that the MAI would be binding on the host country to allow foreign multinational companies the full right to both establish [a] new presence and to expand their [existing] presence in the manufacturing, services and other sectors of the economy in addition to the right to take part in new privatisation exercises... the MAI could also lead to eventual foreign domination of the banking and financial sector, a totally unacceptable political proposition".[72]

Nevertheless, the writing on the wall was clear. As already noted in a previous section, the expectation was that global rules would eventually allow foreign corporations unrestricted access to the domestic market. It was clear that Malaysian firms, including the politically privileged ones, would eventually have to compete with global firms, not only in international markets but in the domestic market as well. If domestic firms were not ready for global market competition, their demise would have significant political repercussions for the NEP goal of advancing a Malay business class, for Mahathir's personal authority, and ultimately for the stability of Mahathir's ruling coalition as well as the security of the UMNO-dominated political system. The new business elite nurtured through the state by Mahathir were also important players in Malaysian patronage politics The developmental role envisaged for the AIA by the Malaysian side was, therefore, intimately related to ensuring the survival of these domestic firms that were key players in the Malaysian political economy.

[71] Interview via e-mail.
[72] E-mail interview.

6. Conclusion

By examining the interaction between globalisation and domestic political economy dynamics, this chapter shows that policymakers and leaders in the ASEAN countries were also concerned with ensuring the growth and viability of domestic firms as with their anxiety over FDI inflows. While both forms of regionalism associated with AFTA – open and developmental regionalism – were driven by the growth imperative, distribution concerns were weaved into the concern with growth in the case of developmental regionalism, with its especial emphasis on nurturing the development of domestic capital in anticipation of global market competition.

A number of economists studying AFTA, notably Ariff (1998: 10), have suggested that AFTA provides a "training ground where ASEAN manufacturers will learn to compete with one another in the regional market before they can penetrate into the world market." This line of thinking is distinct from the notion of developmental regionalism advanced in the dissertation, although it appears to share some similarities. There is an inherent contradiction in Ariff's notion of AFTA as a 'training ground', which he implicitly associates with preferential trade liberalisation through the CEPT. Since the CEPT is an instance of open regionalism, and a means to attract foreign investors to the region, there is no explanation of how the "AFTA exercise will enable local manufacturers to spread their wings regionally first and globally afterwards"[73] if international firms are also producing in the region. The latter introduces global market competition in AFTA. The notion of developmental regionalism advanced in this dissertation is fundamentally distinct from the 'training ground' argument, as it makes an explicit distinction between foreign and domestic capital and provides, in addition, an underlying economic model of how domestic capital could theoretically be nurtured through regionalism.

While all the core ASEAN governments used regionalism to facilitate the expansion of domestic capital, governments in Malaysia especially and Indonesia advocated preferential investment treatment of domestic firms in the ASEAN market through the AIA, the idea being to nurture domestic capital to enable them to meet global competition eventually. Governments and leaders of these countries were most concerned about the survival of those segments of domestic capital that were valued for their perceived role in sustaining incumbent elite rule and in helping to underpin the legitimacy and security of the prevailing regime. As to whether the developmental idea of using the AIA to build up domestic firms was workable is not the main concern of the analysis, however, which is to account for the anomaly the AIA presents to prevailing FDI-centred explanations of AFTA. Nevertheless, it has now become widely accepted among corporate analysts in the region that large-sized firms are better able to survive competition with global multinationals.[74]

Despite the broad commitment to nurture competitive domestic firms through developmental regionalism, implementation proved to be rather more difficult. As the next chapter illustrates in its discussion of departures from AFTA commitments, the imperative of distribution was so overwhelming in certain instances that governments found it difficult to immediately implement their AFTA commitments, including the AIA. Despite the latter's perceived potential to stimulate the development of larger, more capable domestic/ASEAN firms, some governments feared that immediate regional investment liberalisation and the privileging of ASEAN investors would challenge the dominant position of favoured domestic firms in the domestic market.

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[73] Ariff (1998: 10).

[74] See *FEER*, 'Asia learns size matters', 7 June 2001.

CHAPTER 5

RE-NEGOTIATING AFTA COMMITMENTS:

Domestic Politics and the Distributive Imperative

1. Introduction

The previous two chapters show how both open and developmental regionalism in AFTA were driven by concern with growth as the ASEAN governments responded to the pressures of globalisation, although distributive concerns were weaved into the concern with growth in developmental regionalism as governments also sought to nurture domestic capital. The tension between growth and distribution in the ASEAN countries was, in fact, a constant theme during the 1990s. In some instances, distributive concerns overwhelmed the concern with growth as governments sought to protect certain social groups and selected firms against the competitive effects of regional liberalisation. In these instances, governments were prepared to renegotiate their original AFTA commitments to protect the interests of these politically important social groups and of domestic firms with close ties to the political elite. Section 2 elaborates on this theme by focusing broadly on the implementation of regional liberalisation commitments in manufactured goods, investment and services. Sections 3 through 5 present three specific cases of disputes over implementation – petrochemicals, agriculture and automobiles – which clearly illustrate how departures from AFTA commitments occurred to protect firms with close ties to the political elite.

2. Resistance to AFTA: A General Survey

Despite the advances made in AFTA, as described in Chapter 2, the regional project was not without problems. Although member governments often made ambitious commitments for liberalisation, they sometimes failed to implement the commitments already made.

This problem occurred in virtually all the component programmes in AFTA, although some issue areas experienced greater setbacks that others.

2.1 The CEPT

Chapter 3 explains how external pressures from globalisation drove advances in AFTA, including the renewed commitment in 1993 to implement the CEPT. This occurred despite growing opposition from certain domestic business interests, particularly in Thailand, the Philippines and Indonesia who were in favour of going slow on or even withdrawing from AFTA commitments. These included, for instance, the Philippines Chamber of Commerce and Industry,[1] the Indonesian Automobile Industry Association (GAIKINDO),[2] the Thai petrochemical industry,[3] Thai electronics, plastics product and iron and steel firms, and Philippine apparel, footwear and iron and steel firms.[4] On the other hand, other business actors from these countries supported AFTA. Thus, Indonesian businesses with export capabilities like the Salim group wanted AFTA hastened[5] in some issue areas, while export-oriented Philippine and Thai industrialists welcomed the adoption of the AFTA project[6] as did the Federation of Malaysian Manufacturers.[7] The picture is one of diversity of domestic business attitudes to AFTA in the ASEAN countries.

The diversity of business demands with regard to tariff liberalisation in goods trade meant that policymakers were, by and large, able to adopt a fairly independent course based on calculations of the broad policy interest of the government. As Chapter 3 shows, the

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[1] *Review Indonesia*, 8 April 1992.
[2] *Suara Karya*, 9 August 1995.
[3] *Bisnis Indonesia*, 7 December 1992.
[4] See Stubbs (2000: 307-8).
[5] *Jakarta* Post, 17 November 1992; and Suara *Karya*, 30 March 1992.
[6] *Merdeka*, 13 August 1992; *Jakarta Post*, 16 December 1993; and *Bangkok Post*, 'FTI asked to submit tariff cut list', 20 May 1999.
[7] *Jakarta Post*, 25 February 1993.

overriding concern of the ASEAN governments was on growth, efficiency and competitiveness, particularly where the CEPT was concerned. These governments were committed to using the CEPT and AFTA as a means to create a regional market to which foreign investors would be attracted and which would also provide the space for the expansion of outward-looking domestic capital. As a result, governments generally resisted demands from firms wishing to delay the CEPT. Governments were, nevertheless, sympathetic to business concerns about regional trade liberalisation and dealt with them in various ways. A range of domestic adjustment measures was adopted to help domestic firms, particularly in Thailand and the Philippines.[8] Moreover, these governments also negotiated a more flexible mode of CEPT implementation that gave domestic firms sufficient time to prepare for regional trade liberalisation.

The ASEAN governments continued since then to resist demands from domestic business to delay CEPT implementation, including during the financial crisis period.[9] In Indonesia, the head of the National Business Development Centre called for the 2003 target date for the CEPT to be postponed to 2010 in view of the regional economic crisis. The government's economic advisory council, however, rejected the demand.[10] By this time, Indonesia had adopted the IMF bailout package of reforms, and reneging on the CEPT would not have sent the right signals to the international investors that the country was keen to attract. The Federation of Philippine Industries also asked the government to suspend CEPT implementation until 2003[11] but its demand was not entertained except in

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[8] These included financial and technical assistance, reduced utility charges, as well as fiscal incentives. See *Business Times*, 'Bangkok sets up fund to help local industries', 14 June 1993; and *Business Times*, 'Philippine government to help industry compete in region', 19 November 1992.
[9] Although import restrictions were adopted during 1998-99 in a number of the ASEAN countries, these were temporary, a direct response to the crisis-induced economic slowdown, and thus not significant instances of protectionism. See the discussion in Chapter 3 (Section 4.2).
[10] *Jakarta Post*, 'Local businessmen want implementation of AFTA delayed', 12 July 2000.
[11] *Business Times*, 'Philippine industries want tariff freeze until 2003', 4 September 1998.

the case of petrochemicals, which the government temporarily excluded from the CEPT. Similarly, the Thai government refused to accede to business demands to delay the CEPT.[12] Although Malaysia excluded automobiles from AFTA disciplines, the government rejected all other business demands, which were quite considerable, for delaying CEPT implementation.[13]

One question that arises is why out of all other business demands for protection the Malaysian government negotiated to withdraw, albeit on a temporary basis, automobiles from AFTA disciplines beginning from 2000. The Malaysian automobile case is especially interesting because the government came under considerable pressure from the Thai government and from foreign investors to refrain from this move. As for petrochemicals, this case is noteworthy less for the Philippine decision to temporarily exclude petrochemicals and more for Indonesia's move during the 1990s to raise tariffs on selected petrochemical products without any prior warning to its AFTA partners. In a similar move, Indonesia had withdrawn 15 categories of agricultural items from AFTA, backtracking on its initial commitment to subject these items to CEPT liberalisation. In both these instances, Indonesia's move sparked off a row within ASEAN. These three cases – petrochemicals, agriculture and automobiles – will be discussed later in the chapter. They reveal how ASEAN governments, despite the overall commitment to AFTA were, nevertheless, prepared to re-negotiate their original commitments in particular instances in order to protect the interests of politically important social groups and of domestic firms that had close ties to the political elite. The distributive imperative clearly predominated.

[12] Interview with Ms Chularat Suteethorn of the Thai Ministry of Finance, August 2000.
[13] Confidential interview with a Malaysian trade official, August 2000.

2.2 Investment and Services.

Although the ASEAN governments led by Malaysia designed the AIA as a developmental tool to nurture the growth of domestic capital, the reality of domestic interests meant that even this project faced some difficulty in implementation. Member governments found it hard to offer national treatment and market access privileges to ASEAN investors initially, since even that was expected to adversely affect domestic firms. These governments managed to negotiate a flexible mode of implementation similar to the CEPT model that incorporated both a temporary exclusion list and a sensitive list that would delay investment privileges to ASEAN firms for different periods of time.

Interestingly, member governments chose to place most of the sectors they wished to exclude from the AIA in the sensitive list rather than the temporary exclusion list, thereby maintaining indefinite protection from all, including ASEAN, investors.[14] Malaysia, for instance, had been against the initial suggestion by Thailand to extend national treatment privileges to ASEAN investors by 2003.[15] This is surprising, given that Malaysia was the main proponent of using the AIA as a developmental tool, and would at least have been expected to endorse the early realisation of the AIA. The reality, however, was that many domestic firms, particularly those in the protected services and import-competing sectors, were too important politically to be exposed to even the limited competition that liberalisation to ASEAN investors might entail. Incidentally, national legislation has yet to be put in place in many member countries to differentiate ASEAN from foreign investors.[16]

[14] See Table 2.13 in Chapter 2.
[15] *Bangkok Post*, 'Trade hurdles must be cleared today', 12 December 1998.

Moreover, the plan to use the early privileges accorded to ASEAN investors to stimulate the growth of alliances between ASEAN country domestic firms also became a casualty of the business-politics relationship so prevalent in the region. A notable example is the rejection by the Malaysian government of a proposal by the Renong Group, a prominent Malaysian conglomerate, to form a strategic tie-up with Singapore Telecommunications (SingTel), a corporation linked to the Singapore government.[17] The Malaysian Prime Minister had reportedly been against the idea of a close connection between Renong, which had close ties with the ruling Malay party, UMNO, and the Singapore PAP government.[18]

There has been a long history of mutual suspicions between the Malaysian and Singaporean governments in general, and their two respective governing parties, UMNO and the PAP in particular. Singapore had briefly been a part of the Malaysian federation from 1963 to 1965 when it was 'expelled' from the federation due to fundamental political differences between the two parties.[19] These differences centred on the notion of a 'Malaysian Malaysia' advocated by the PAP that challenged the 1957 terms of independence negotiated with the British that emphasised Malay political dominance in Malaysia in return for citizenship rights for the ethnic Chinese and Indian immigrant communities (Crouch, 1996: 22). The PAP formula endorsed equal political status for all ethnic communities. It was clearly difficult for the Malay/UMNO elite to allow a company with close political connections with the PAP government in Singapore to acquire a stake,

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[16] Follow-up interview via e-mail with Ms Lim Bee Suan of the Singapore Trade Development Board, June 2001. The significance of this point should not be exaggerated, since legislation often lags behind policy shifts in many countries.

[17] Details of the episode are found in *FEER*, 'Changing lanes', 8 June 2000.

[18] Renong is, in fact, the former business arm of UMNO. See Gomez and Jomo (1997: 69).

[19] See Lee (1998).

even a non-controlling one, in Renong, a showcase of Malay corporate success and a key member of the ruling ethnic Malay elite coalition.

As for services, the ASEAN governments found it especially difficult to advance their negotiations to obtain specific commitments to liberalise trade in services in the financial and telecommunications sectors.[20] Malaysia was especially unwilling to consider liberalising foreign equity and market access conditions for financial services, which Singapore and Thailand favoured. This is unsurprising, since domestic banks were key players in the Malaysian patronage system, and liberalisation would have reduced the space for patronage-based maneouvering to take place (Gomez and Jomo, 1997).

Similarly, domestic firms with strong ties to the political elite, such as Renong discussed above, were prominent players in the telecommunications sector, which made it difficult for the Malaysian government to commit to broad-based liberalisation in this sector that might have jeopardised their dominant position. To governments in Singapore and Thailand, advancing negotiations in services was important since domestic capital was concentrated in finance and telecommunications respectively, and was looking to the regional market for expansion. In addition, the slowdown in the pace of services negotiations at the GATS weakened the pressure on ASEAN to keep pace with global developments in AFTA.[21]

The following three cases – in petrochemicals, agriculture and automobiles – illustrate clearly the sensitivities involved when sectors in which domestic firms with close political connections are required to liberalise. In these instances, distributive concerns with

[20] Interview with Dr Suthad Sethboonsang, Deputy Secretary General of ASEAN, July 2000.
[21] Confidential interview with a Malaysian trade official, August 2000.

ensuring that economic gains or rents went to politically important social groups, and especially to firms and individuals with strong ties to the political elite, led governments to attempt to re-negotiate their original AFTA commitments. This led to disputes with other member governments that did not share these same concerns and for whom the original commitments yielded superior outcomes.

3. Tariff Liberalisation of the Petrochemicals Sector in AFTA

The tensions that emerged in AFTA over tariff liberalisation in the petrochemicals sector had their roots in the designation of the petrochemical industry as a strategic industry in four ASEAN countries – Malaysia, Thailand, the Philippines and Indonesia. These governments believed that a domestic petrochemical industry was fundamental to industrial development, particularly in view of the industry's substantial linkages with other, downstream industries like textiles, chemicals, plastics, and fertilisers. Apart from the Philippines, the other country projects had been initiated even before the decision to form AFTA had been made.[22]

While it would have made economic sense to perhaps settle for one such industry within ASEAN, national governments were not willing to forgo national plans to develop a domestic petrochemical industry. Investments had already been committed to the project in the four countries, which involved state and private, including foreign, capital. Because huge capital investments and a long gestation period were necessary, state capital was often necessary, which made national governments committed to ensuring the project's viability. This often included tariff protection. Private investors, both domestic and foreign, had also committed to participating in these projects on the understanding that the

[22] Singapore already possessed a petrochemical industry that had its roots in the petroleum refining and petroleum products industries begun in the late 1960s (Rodan, 1989: 96-101).

projects would be accorded protection, at least initially. Moreover, politically connected firms that were involved in this sector often used their political influence to demand tariff protection, in the process overturning official policy as in the case of Indonesia.

It is, thus, unsurprising to find that this sector was subject to tensions among the core ASEAN governments as each sought to protect its own strategic industry, often reinforced by demands from the domestic and foreign firms involved. Apart from Thailand and the Philippines, tariffs on petrochemical products in ASEAN were very low at the start of the 1990s, mostly between 5 to 10 per cent. Malaysia, however, raised tariffs on key petrochemical items to 30 per cent in 1992, while Indonesia imposed customs surcharges and hiked tariffs in 1993, 1996 and 1997.

3.1 Thailand: The Influence of Big Business

The petrochemical industry in Thailand began when the government established an upstream petrochemical industry in 1989 as a joint venture between state and private capital, and accorded the industry promoted/strategic industry status (Lucas, 1998: 72). The upstream petrochemical industry soon grew, producing a range of petrochemical resins like polyethylene (PE), polypropylene (PP), and polyvinyl chloride (PCV) that were used in downstream industries like plastics, textiles, and fertilisers. The industry was comprised almost entirely of Thai capital, particularly the Bangkok-based big business groups like Siam Cement, Thai Petrochemical Industries, Vinythai and HMC Polymers (Lucas, 1998).[23] Many of these conglomerates had extended their original downstream activities in plastic products and textiles to venture into the upstream sector to produce petrochemical resins.

This move was part of a larger trend in the 1990s of Thai conglomerates moving into heavy industries like cement, steel and power, in addition to petrochemicals (Phongpaichit and Baker, 1998: 43). They were encouraged by government policy to deepen Thailand's industrial structure, which meant substantial investment incentives. Moreover, foreign capital was increasingly dominating export-oriented manufacturing activities, and Thai conglomerates had begun to look elsewhere for market opportunities. They found it in heavy industries, where their local knowledge and political clout provided them with an advantage over foreign investors (Phongpaichit and Baker, 1998: 28).

By the mid-1990s, however, excess domestic capacity affected profitability, while export markets were not readily available since most countries in ASEAN and in the other East Asian countries had their own supplies from domestic firms (Phongpaichit and Baker, 1998: 45). The petrochemical industry, thus, lobbied hard to prevent the scheduled reduction in import duties on petrochemical items from 27 to 20 per cent due in 1998 under the CEPT fast-track schedule. Downstream producers of plastics and textiles that used petrochemical inputs, on the other hand, wanted tariffs lowered.[24] These firms, however, did not have the bargaining power of the large firms owned by some of the country's most powerful business families that dominated the upstream sector. The latter, particularly through the Federation of Thai Industries, was successful in influencing the industry ministry and the Board of Investment to back their demands for tariff protection.[25] Both these government agencies argued that the petrochemicals sector was a vital industry that needed to be nurtured.[26] The Finance and Commerce Ministries, on the other hand,

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[23] Also see *Bangkok Post*, 'Producers want tariff protection extended', 10 June 1997.
[24] *Bangkok Post*, 'Thai PET resin firms worry over duty cuts', 9 September 1996.
[25] *Bangkok Post*, 'Industry ministry lobbies against plastic duty cuts', 4 December 1997.
[26] *Bangkok Post*, '1,600 products benefit from duty cut', 29 November 1996.

opposed the tariff move, citing the need for Thailand to conform to its CEPT commitment.[27]

Big business also used the decision by Indonesia to raise tariffs on petrochemicals to press its own case in Thailand, citing the unfair competition in AFTA that would ensue should Thailand press ahead with tariff reductions before its ASEAN counterparts.[28] The Finance Ministry agreed in May 1999 to allow petrochemical tariffs to remain above 20 per cent for a three-year period to allow affected firms sufficient time to adjust to increased competition. In doing so, Thailand departed from the CEPT fast-track schedule for petrochemicals, although petrochemical tariffs were expected to reach the 0-5 per cent AFTA target by 2003.[29]

3.2 The Philippines: Developing a Domestic Strategic Industry

In the early 1990s, the Philippine government initiated moves to establish an upstream and mid-stream petrochemicals industry, in which state capital would cooperate with domestic and foreign private capital (Lim, J, 1998: 140). The upstream project experienced great difficulties, despite initial interest shown by foreign investors from Taiwan and Thailand. The former later invested in Malaysia. These firms were caught in a domestic controversy aroused by nationalist sentiment against preferential treatment to foreign firms. Later, a consortium of domestic, foreign and state capital was formed to develop the project, although internal disagreements caused further delays (Lim, J, 1998: 141).

The problems facing the industry were compounded when, in a paradoxical move in 1995, the government issued Executive Order #264 that immediately lowered tariffs on

[27] *Bangkok Post*, 'Agencies in two camps over tariff cut delay', 17 December 1996.
[28] *Ibid.*

petrochemical items to 10-15 per cent from the prevailing 20-30 per cent. This led to an outcry by domestic business who alleged that the move would place the Philippine petrochemical industry at a disadvantage in the regional market (Lim, J, 1998: 141-52). The Philippine government, thus, sought a temporary delay in submitting petrochemicals to AFTA disciplines as a way of helping to get the local industry on its feet after the ups and downs experienced by the project since its inception. Although the Philippines was the only other country apart from Malaysia (for automobiles) that attempted to temporarily withdraw a product from AFTA, this move was not as controversial as Indonesia's tariff hikes on petrochemicals.

3.3 Malaysia: A Strategic Industry and Politically Important Firms

Malaysia raised tariffs on petrochemical items, notably PP and PE, to 30 per cent in 1992.[30] Although this hurt downstream producers of plastics, who demanded a review of the tariff, the government maintained the high tariff to protect the fledgling petrochemical industry, dominated then by Titan Polyethylene, a Taiwanese investor.[31] Moreover, in April 1994, a new policy was instituted that required government approval for the import of PP and PE. Malaysian plastics firms criticised this move, since it raised the cost of petrochemical inputs while also reducing the availability of supply. Ostensibly for a two-year period, the 'approved import' scheme also benefited Titan, the major producer of PP and PE in Malaysia.[32] While reiterating Malaysia's commitment to CEPT tariff reductions, the Malaysian Trade Minister, nevertheless, justified the import approval scheme as necessary to allow fledgling, strategic industries sufficient time to become profitable.[33]

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[29] *Bangkok Post*, 'Petrochemical, steel tariff cuts gradual', 1 May 1999.
[30] *Business Times*, 'Protection for petrochem products will be temporary', 19 September 1992.
[31] *Business Times*, 'Association: Review protective duty on polyethylene', 26 February 1994.
[32] Interview with Dr Leong Choon Heng, Director of Research at the Malaysian University of Science and Technology, in August 2000 in Kuala Lumpur.
[33] *Business Times*, 'Rafidah: 40,000 permits issued for import of resins', 25 May 1994.

Part of the reason for the favourable treatment meted to Titan may be its importance in the context of Malaysia's heavy industries programme first begun in the early 1980s by Prime Minister Mahathir. Petrochemicals were regarded as a key strategic industry vital for developing an integrated Malaysian industrial sector. Titan, which had been considering investing in the Philippines, had been wooed by the Malaysian Trade Minister to Malaysia to spearhead this process.[34] Interestingly, Titan's local partner was PNB (*Permodalan Nasional Berhad* or the National Equity Corporation) that had been set up in 1978 to increase the Malay share of corporate wealth by purchasing and holding shares on behalf of the community. Moreover, a second petrochemical plant, this time involving the state oil agency, Petronas, was expected to come on-stream in late 1994.

Petronas, which had substantial financial, including foreign exchange reserves, as well as PNB were key players in the Malaysian political economy, particularly in Malaysian patronage politics.[35] The political importance of these domestic investors in the petrochemicals industry coupled with the role envisaged for the sector in national development plans explains why the government chose to take actions that ran counter to the CEPT. Although Malaysia had informed its AFTA partners of its plan to introduce the import permit scheme, this did not prevent intra-ASEAN tensions, particularly with Singapore, long a major supplier of petrochemical products to Malaysia.[36]

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[34] *Malaysian Business*, 'Pioneering the big play', 16 October 1993.
[35] See Crouch (1996: 201-202). Petronas funds had been used a number of times to bail out other politically important firms, for instance, the government-owned Bank Bumiputera in 1984 (Gomez and Jomo, 1997: 38) and the shipping conglomerate owned by the Prime Minister's son in 1998. See *AWSJ*, 'Petronas's purchase plan fuels question', 9 March 1998. In 2000, Petronas took a 27 per cent equity stake in Malaysia's national car firm, Proton, providing it with much-needed funds during a critical period in the latter's history. See *Business Times*, 'Mitsubishi sees only minor changes in Proton management', 24 July 2000. Proton is discussed in Section 5.2 of this chapter.
[36] Singapore filed a complaint (#95-01) at the WTO challenging the legality of this move. It later withdrew the complaint once the Malaysian government removed the offending NTB (Schott, 1996: 8).

3.4 Indonesia: Policy Reversals for the Politically Connected

When Indonesia agreed in 1992 to include petrochemicals in the CEPT fast-track inclusion list, the country's tariffs on petrochemical imports ranged from 5 to 20 per cent. In 1993, however, the authorities raised the tariff on plastic pellets from 5 to 20 per cent, while also imposing an additional 20 per cent customs surcharge (van der Eng, 1993: 30). In early 1996, the authorities extended the 20 per cent customs surcharge to cover five additional petrochemical items.[37] In early 1997, the surcharge was replaced by a tariff of 20 per cent on eight petrochemical items under Finance Ministry Decree #94. The tariff reduction schedule in this Decree was made consistent with the CEPT schedule of tariff reduction, although it challenged members' expectation of a standstill on tariffs under the CEPT.

Two months later in April 1997, an amendment to Decree #94 was issued. Decree #151 transferred these eight items from the CEPT inclusion list to the temporary exclusion list as well as raised tariffs on them to between 25 and 40 per cent. No prior notice of these actions had been given to Indonesia's ASEAN partners. According to the new tariff reduction schedule, tariffs on these petrochemical products would remain above 20 per cent in 1998, which contravened the CEPT fast track schedule, only falling gradually to the 0-5 per cent target in 2003.[38] Indonesia's move increased tensions in ASEAN.

It is likely that the close involvement of conglomerates associated with the friends and family of President Suharto in the petrochemical industry were partly responsible for these specific tariff reversals in 1993, 1996 and especially in 1997, which occurred amidst the broad policy trend in the country towards trade liberalisation. The 1993 customs surcharge and tariff hike on plastic pellets benefited PT Petrokimia Nusantara Interindo, a joint

[37] *Jakarta Post*, 16 October 1997.
[38] Details are found in *Bisnis Indonesia*, 22 October 1997.

venture between British Petroleum and Indonesian companies controlled by Suharto's son, Sigit Harjoyundanto that had just begun to produce similar pellets (van der Eng, 1993: 30). The additional tariff hikes of 1996 and 1997 benefited the US$1.6 billion olefin project of the Chandra Asri consortium and the US$600 million Arun Aromatic centre. The Chandra Asri project located in West Java was a joint venture between Japanese investors and three influential Indonesians, including Prajogo Pangestu, a prominent ethnic Chinese business tycoon and a close personal friend of President Suharto as well as Bambang Trihatmodjo, another of Suharto's sons (Hill, 1992: 17). A third Suharto son, Tommy Mandala Putra, was involved in the Arun project located in North Sumatra.

The Chandra Asri case is especially interesting because it brings into sharp relief the influence of patronage politics on economic policymaking in Indonesia. Although bureaucrats essentially drive broad policy change in Indonesia, whether they are liberal technocrats or economic nationalists, the Chandra Asri case reveals how business actors were able to overturn specific policy decisions through their close connections with the ruling elite, notably with the President himself (Surbakti, 1999: 67-68). When in December 1994 Chandra Asri formally petitioned the government to introduce a tariff of 35-40 per cent on competing imports, the finance minister Mar'ie Muhammad, a noted liberal technocrat, rejected the request. The President then intervened, re-assigning the authority to grant tariff requests from the finance minister to the Coordinating Minister for Industry and Trade, Hartarto who was more supportive of Chandra Asri's petition (Hobohm, 1995: 29).

The favouring of Chandra Asri is said to represent the return of a favour by the President to Prajogo Pangestu.[39] As already noted in Chapter 4, ethnic Chinese business groups in Indonesia have often provided funding for other troubled firms and state enterprises when asked by the President, a practice that has safeguarded the operations of Chinese businesses in a country in which ethnic Chinese are often regarded with suspicion. In return, these businesses receive benefits that help their activities, such as state concessions and licenses. Prajogo Pangestu had provided US$220 million in 1990 to help cover the US$420 million that Bank Duta, the country's fifth largest private bank had lost in foreign exchange speculation (Djidin, 1997: 28; Borsuk, 1999: 145). Information about the bank's losses had been kept away from the thousands of ordinary Indonesians who had purchased shares in the bank. The Bank Duta affair was a potential political minefield for the President since three of the charitable foundations that he chaired held a majority 72 per cent stake in the bank (Borsuk, 1999: 145). Suharto turned to his two close ethnic Chinese allies – Prajogo of Chandra Asri and Liem Sioe Liong of the Salim group – who provided the necessary bailout funds.

4. Liberalisation of Unprocessed Agricultural Products in AFTA

In early 1995, the Indonesian government backtracked on its earlier decision to commit 15 unprocessed agricultural products to CEPT liberalisation by 2003. Indonesia had proposed to transfer these products from the temporary exclusion list to the sensitive list that would effectively accord these items indefinite protection. The main product groups withdrawn by Indonesia were rice, sugar, cloves, and wheat flour. Thailand then threatened to withdraw 44 agricultural items from AFTA in retaliation.[40] Although a compromise was worked out to extend the original 2003 deadline to 2010 for these particular products to

[39] Interview with Dr Hadi Soesastro, Executive Director of the Centre for Strategic and International Studies in Jakarta, July 2000.

accommodate Indonesia, Indonesia soon backed away from the revised arrangement despite initially endorsing the new deadline.[41] Further negotiations became necessary. The episode raised considerable tensions within ASEAN, notably between Thailand, an agricultural exporter, and Indonesia. How the matter was resolved will be discussed in the next chapter. This section focuses on the domestic political economy dynamics that drove the Indonesian actions.

The Indonesian authorities explained their actions in terms of the need to safeguard the welfare of Indonesia's substantial rural community. Indonesian Minister of Trade and Industry in 1995, Tunky Ariwibowo, pointed out that "all of these items are sensitive items that have an influence on the welfare of our farmers".[42] The interesting point is that Indonesian intransigence on this issue is only partly explained by the government's wish to secure the welfare of farmers. While the CEPT could have introduced cheaper rice and sugar imports from other producer countries in ASEAN like Thailand and the Philippines, thereby adversely affecting farmers' incomes, wheat is not grown in any ASEAN country, while only Indonesia grows cloves.[43] It is thus in the case of rice and possibly sugar that the argument about protecting the welfare of domestic farmers is most relevant. In the case of the other agricultural items, their withdrawal from the CEPT was related to their role in the business activities of individuals and firms with close connections to the political elite.

4.1 Rice and Rice Farmers in ASEAN

Rice is one of the most regulated agricultural commodities in ASEAN, through both trade policy restrictions and domestic price stabilisation schemes. Both these policy instruments

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[40] *AWSJ*, 'ASEAN defuses trade dispute with Jakarta', 11 December 1995.
[41] *AWSJ*, 'ASEAN fine tunes services liberalisation', 12 December 1995.
[42] *AWSJ*, 'ASEAN defuses trade dispute with Jakarta', 11 December 1995.
[43] *AWSJ*, 'ASEAN fine-tunes services liberalisation', 12 December 1995.

helped the governments concerned to maintain adequate supplies of rice, the staple food in the region, as well as to ensure a stable minimum price to farmers and a stable maximum price to consumers (Acosta, 1998: 38). The rice stabilisation scheme in Indonesia was under the sole control of the National Logistics Agency (BULOG). For Thailand, rice was also a major export, which explains the Thai government's interest in securing market access for rice in ASEAN, long a closed market for rice imports. This was, however, easier said than done.

Indonesia

Rice farmers were a politically important group in Indonesia, given the country's large rice farming, rural community and Indonesia's official policy of self-sufficiency in rice for purposes of national security (Hill, 1994: 72-78). As already noted in Chapter 3, increased material wellbeing of Indonesian citizens was one of the key bases of legitimacy of the Suharto regime, and the country's rice policy and indeed its actions to re-negotiate tariff liberalisation of the rice sector in AFTA need to be viewed in this context.[44] Although rice self-sufficiency was attained in 1985, rice imports were, nevertheless, allowed whenever domestic output was insufficient to meet domestic demand or to replenish emergency buffer stocks. The authorities, however, preferred to control the quantity and price of rice imports, with BULOG given sole importing authority. Although formal MFN tariffs on rice were fairly low, around 17 per cent in the early 1990s,[45] later reduced to zero in the deregulation package of 27 June 1994,[46] these rates were unbound at the GATT/WTO. This allowed the Indonesian authorities to maintain higher effective tariff rates whenever necessary in order to stabilise domestic rice prices and insulate the home market from

[44] This was despite the declining political and economic salience of rice since the 1970s, the result of structural economic transformation and rural income growth (Tomich, 1992: 25).
[45] See Acosta (1998: 197).

import competition. Nevertheless, the import of rice, even if necessary due to domestic production shortfalls, never became politically acceptable (Manning and Jayasuriya, 1996: 28).

Malaysia and the Philippines

Rice was a politically sensitive product for Malaysia and the Philippines as well, and these governments joined Indonesia in attempting to re-negotiate the final tariff rate and target date for liberalisation of rice tariffs. For the governments of both these countries, rice farmers were an important political constituency, although the political salience of rice farmers had declined in Malaysia since the 1970s with the fall in the share of agriculture in the economy.[47] Nevertheless, the majority of rice farmers in Malaysia are ethnic Malays concentrated in the Northern states of Kedah, Perlis and Kelantan where the opposition Islamic party, PAS[48] is a strong contender for the Malay vote. This demographic fact continues to give political salience to rice farmers in Malaysia and explains Malaysia's decision to re-negotiate rice tariffs in AFTA.[49] The Philippine government also chose to re-negotiate the tariff liberalisation schedule for rice in order to maintain the livelihood of Philippine rice farmers, much to the disquiet of Thailand. The Philippines maintained MFN tariffs on rice imports at 30 per cent (Acosta, 1998: 197).[50]

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[46] See Pangestu and Azis (1994: 25). The Finance Ministry, nevertheless, set the unofficial maximum MFN rice tariff at 160 per cent. See *Bisnis Indonesia*, 2 October 1999.

[47] The share of agriculture in GDP declined from 23 per cent in 1980 to 16 per cent in 1992. In contrast, the share in the Philippines remained at close to a quarter of GDP in 1992. See McFarlane (1998: 152).

[48] PAS is the Pan-Malaysian Islamic Party (or *Partai Agama Islam Se-Malaysia*).

[49] Although the MFN tariff on rice between 1990 and 1995 was low, set at 0.3 per cent, import prohibitions and licensing regulations, many of them not fully transparent, offered substantial protection to domestic rice farmers. See Acosta (1998: 39).

[50] Economists predicted that the price of rice would slump if rice tariffs were liberalised under AFTA (Acosta, 1998: 181).

4.2 The Political Economy of Trade Liberalisation of Wheat, Sugar and Cloves

The Indonesian decision to withdraw wheat flour, sugar and cloves from Indonesia's CEPT inclusion list was surprising since tariffs on these items were very low at the time the dispute emerged in 1994-95. In fact, prevailing tariffs on wheat flour and sugar were set at zero, although domestic monopoly arrangements constituted a significant NTB on imports (Pangestu and Azis, 1994: 25). Although Indonesia undertook fairly extensive economic reforms during the 1990s, these monopolies remained untouched (Borsuk, 1999: 144). These arrangements benefited powerful state-owned enterprises, especially BULOG, and politically connected firms and individuals who often worked with BULOG to exploit the rents from these monopolies. BULOG, incidentally, was the sole agency authorised to import sugar and wheat flour into Indonesia (Chung *et al*, 1998: 32).

Under AFTA rules, NTBs on any product included in the CEPT would have to be removed within five years (ASEAN Secretariat, 1996: 31).[51] If Indonesia agreed to include these particular agricultural items in the CEPT, it would also have been required to dismantle the domestic monopolies associated with them. The authorities chose, instead, to withdraw wheat, sugar and cloves from the CEPT to preserve the monopoly privileges and rents that accrued to these individuals and firms.

Wheat flour and the Salim group connection

For instance, flour milling was monopolised by PT Bogasari Flour Mill, part of the Salim Group under Liem Sioe Liong, a long-standing Suharto ally.[52] Bogasari was a joint venture between Liem and Suharto's adoptive brother and cousin, Sudwikatmono (Habir, 1999: 183). BULOG sold imported wheat to Bogasari at heavily subsidised prices, which

[51] A later decision by the SEOM stipulated that all NTBs are to be removed by 2003. Confidential interview with a Malaysian trade official, August 2000.

Bogasari processed and then sold back to BULOG at a 30 per cent premium.[53] Consumers and downstream industries paid higher prices for wheat flour, although the Salim group gained cheap wheat flour for its instant noodle activity, one of the fastest growing markets in Indonesia and the world. AFTA tariff liberalisation would have challenged BULOG's monopoly on wheat flour imports, which would have ended the monopoly rents that went to private firms like Salim and Bogasari.

Interestingly, Bogasari's articles of incorporation provided for 20 per cent of its profits to be channelled to two charitable foundations run by the President's wife and the military (Habir, 1999: 183). Suharto had established the charitable foundations to dispense funds, often collected through contributions from his friends and business associates in the ethnic Chinese community, to selected organisations and individuals in return for political support (Liddle, 1999: 51-52). It was therefore unsurprising that the government sought to withdraw wheat flour from the CEPT, despite having initially agreed to its inclusion. It was likely that the politically influential Liem had made the necessary representations to trigger the policy reversal.[54]

Sugar and the state-owned enterprises

The sugar industry in Indonesia is dualistic, comprising a modern, efficient sector that operates in southern Sumatra and is essentially privately owned.[55] An inefficient, state-owned sector operating outdated refineries also exists, concentrated in eastern Java and

[52] Liem's role in helping the President to bail out Bank Duta was discussed in Section 3.4.
[53] *FEER*, 'Depth of Connections', 16 October 1997.
[54] In fact, the wheat flour sector had initially been targeted by the government for deregulation in the mid-1990s, but was apparently left off the deregulation agenda after Liem had pointed out to government officials that Suharto's daughter also owned a flour mill. See *FEER*, 'Depth of connections' 16 October 1997.
[55] The discussion in this sub-section benefited from the author's interview with Dr Hadi Soesastro of CSIS, Jakarta.

survives through protection from import competition. Even in the more liberal policy environment of the 1990s, state-owned enterprises possessed substantial political clout, largely due to their role in fulfilling Article 33 of the Indonesian constitution that emphasises state control over the economy.[56] They are regarded as 'agents of development', and undertake distribution functions (Mardjana, 1999: 42). State-owned enterprises in the sugar industry were no different.

The control by BULOG of sugar imports, ostensibly to maintain an adequate price to sugarcane cultivators, also allowed the state-owned refineries to sell their refined sugar output to domestic consumers at high prices, earning rents in the process. These state enterprises channelled part of the rents that accrued to local governments in the provinces.[57] This form of arrangement, common in Indonesia throughout the Suharto regime, was a key mechanism the central government used to redistribute income to the provinces, and thus to try and gain political legitimacy. Consumers, however, paid the price, but the Constitution provided the legal and ideological justification for such actions in the name of national development and preserving the unitary state in Indonesia (Mardjana, 1999: 42).

Cloves and Tommy Suharto

Unlike the case of rice, sugar and wheat flour, the sale and marketing of cloves during the 1980s was decentralised. Farmers sold cloves to various traders who resold them to domestic manufacturers of the special Indonesian spice-flavoured cigarettes known locally as *kretek* (Borsuk, 1999: 151). Unfortunately, the income of clove farmers was not steady, as it depended on the prevailing price for cloves. Nevertheless, there was little evidence of

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[56] See also the discussion on state capital in Chapter 4 (Section 5.3).
[57] Interview with Dr Hadi Soesastro.

collusion among the traders to buy low and sell high, as the cigarette-makers could bypass the traders and buy direct from farmers (Borsuk, 1999: 151). This arrangement changed in December 1990 when the government was directed by President Suharto to set up a Clove Support and Marketing Board (BPPC), its official aim being to increase the incomes of clove farmers that it alleged had been suppressed by cigarette manufacturers and clove traders (Hill, 1992: 23). Cloves were thus designated an 'essential commodity' that needed to be regulated by the state. The chair of the new board was Tommy, Suharto's youngest son.

The reality was that in the late 1980s, a group of clove traders, after having failed to corner the domestic clove market, sought out Tommy Suharto to help them set up a government-sanctioned clove monopoly to buy from clove farmers and sell to the cigarette manufacturers (Borsuk, 1992: 151). What the traders had not managed to accomplish on their own was now to be achieved through political influence and state assistance. Although the Board initially bought cloves from farmers at prices higher than the prevailing market price, this could not be sustained in the face of the significant market distortions the Board's actions were creating (Hill, 1992: 23). Amidst public outcry, the President intervened and set a new, lower price for cloves, although the Board continued to sell at far higher prices to cigarette manufacturers. The Board reaped substantial monopoly profits as a result. The President's personal interest in maintaining his son's clove monopoly explains why Indonesian policymakers, even if they privately preferred to see the clove trade deregulated, had to insist on withdrawing cloves from the CEPT.[58]

[58] Hill (1992: 23-24) notes that considerable criticism was directed at the clove board by the House Speaker and the Secretary-General of the government party, Golkar. These individuals, however, wielded little political power in Indonesia's authoritarian, patronage-based political system centred on President Suharto.

4.3 Post-Financial Crisis Developments

The second IMF bailout package signed in 1998 committed the Indonesian government to eliminate BULOG's monopoly over the import and distribution of all agricultural commodities including wheat flour and sugar by February 1998, although rice continued to be regulated by the agency. The clove marketing board was also to be abolished by June 1998 (Soesastro and Basri, 1998: 24). The Habibie government that succeeded Suharto in May 1998 managed to implement these reforms despite resistance from business actors involved in the activities scheduled for deregulation. The ongoing reform process in Indonesia, accompanied by the breakdown of the old patronage coalition centred around Suharto,[59] has made it easier for the government to reach a compromise with its ASEAN counterparts and help resolve the impasse in agricultural liberalisation in AFTA. The next chapter discusses this point in greater detail.

5. Trade Liberalisation of the Automotive Sector[60] in AFTA

All the core ASEAN countries maintained high MFN import tariffs on automobiles during the 1990s, which also applied to trade in autos within ASEAN since all the ASEAN governments had placed autos in their respective temporary exclusion lists.[61] Except for Singapore, all the other governments used high tariffs to shield domestic auto producers from import competition.[62] By 2000, all items in these lists, including autos, were scheduled to be brought within the CEPT and their tariffs immediately lowered to 20 per cent, after which tariffs were expected to fall to the AFTA 0-5 per cent end tariff range by

[59] See Robison and Rosser (2000).

[60] Although the automotive sector comprises a range of vehicles, the discussion focuses on passenger cars, on which the automobile dispute in AFTA centres.

[61] Malaysia had the highest number of automotive sector tariff lines – 246 –in the TEL, compared to Thailand's 7, Indonesia's 45 and 56 for the Philippines. Information is from the ASEAN Secretariat.

[62] Singapore's high tariffs on autos is part of the government's traffic management system, which also includes an area road pricing scheme and an auction system for car import permits.

2002/2003. Malaysia, however, announced in 1999 that it would seek ASEAN approval for a two-year delay for auto trade liberalisation in AFTA. This raised an outcry from the other ASEAN countries but especially from Thailand, which was poised to emerge as the regional centre for auto production spearheaded by foreign capital.

The Malaysian move came at a highly inopportune time – during the financial crisis period. The ASEAN governments, Malaysia included, were under considerable pressure to attract FDI to restore economic growth, and one of the instruments they employed was the potential single AFTA market.[63] They were also keen to reassure foreign direct investors that they remained committed to open markets. Malaysia, especially, had been subject to considerable criticism over its illiberal policy responses to the financial crisis that had culminated in the imposition of temporary capital controls in September 1998 (Khoo, 2000). Malaysia's decision to delay CEPT liberalisation of its auto sector appeared to be ill timed and counter-productive from the point of view of remaining attractive to FDI.

5.1 Indonesia and the Philippines: Late Liberalisers

Although the Philippines had started the decade with high auto tariffs, this was gradually lowered and by October 1999, MFN tariffs on passenger car imports ranged from 10 per cent (for completely knocked down units, CKD) to 40 per cent (for completely built up units, CBU) (Legewe, 2000: 9). Indonesian tariffs on passenger cars too had fallen from 200 per cent to between 65-80 per cent for CBU and from 65 per cent to between 35-50 per cent for CKD under the June 1999 tariff reform exercise (Aswicahyono *et al*, 2000: 224).

[63] This point is discussed in Chapter 3 (Section 4.2).

Before this, the Suharto children had been major players in the industry, protected by the industry's high tariff structure. With the end in 1998 to the controversial national car policy that had allocated preferential benefits solely to Tommy Suharto's Humpuss conglomerate,[64] the Indonesian government adopted a more liberal stance on auto liberalisation in AFTA, rejecting domestic business demands to delay the CEPT for autos.[65] In a bid to help domestic car producers, however, the government decided against according CEPT preferences to the import of second-hand or re-conditioned cars, which were more likely to compete with the domestic industry than new autos.[66]

5.2 The Malaysian and Thai Auto Industries: Divergent Development Paths

Malaysia's move to delay liberalising the auto sector in AFTA and Thailand's vehement response stemmed from the divergent development trajectories of the auto sector in these two countries.[67] Malaysia's industry is essentially state-led, while the private sector has largely driven developments in the Thai automobile sector although the Thai government had attempted to shape the industry's development path using policy instruments such as the tariff and local content regulations. Their dissimilar development paths reflected distinct domestic political economy dynamics. The auto industry in Malaysia was designed to fulfil multiple objectives, economic as well as political, through the country's national car project. The Thai industry, on the other hand, was not beset by such demands.

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[64] Details of Indonesia's national car project are found in Borsuk (1999: 147-49) and Aswicahyono *et al* (2000).

[65] The Indonesian Automobile Industry Association, GAIKINDO had raised this issue a number of times since 1999. See *Bisnis Indonesia*, 8 December 1999; *Jakarta Post*, 28 June 2000; and *Jakarta Post*, 6 July 2000.

[66] Interview with Dr Haryo Aswicahyono, an economist with the Centre for Strategic and International Studies in Jakarta, July 2000.

[67] Abdulsomad (1998) provides a comprehensive discussion of the Malaysian and Thai auto industries.

Automobile production in Thailand: driven by foreign capital

Despite their distinct trajectories, the 1960s saw similar import-substitution strategies adopted in both countries based on domestic assembly of cars using imported CKD kits (Abdulsomad, 1998: 275). It was only from the 1980s that the development paths of the auto industries in Thailand and Malaysia began to diverge. The Thai industry continued along the protected, import-substitution path begun in the 1960s and involved private local and foreign capital. In 1991, however, the Thai industry was liberalised substantially, part of the broader liberalising trend initiated by the post-coup government of Anand Panyarachun (Thailand, 2000). Some restrictions were maintained, notably local content regulations.[68] Nevertheless, the liberalising trend forced domestic automobile assembly and component firms to improve efficiency and produce higher quality cars and components to meet international standards for export (Abdulsomad, 1998: 282). Automotive tariffs under AFTA were reduced to 0-5 per cent in 2000, well ahead of the CEPT schedule, although MFN rates were set at 33 per cent for CKD and 80 per cent for CBU (Thailand, 2000: 11).

Substantial investment from foreign auto-makers and component suppliers flowed into Thailand during the 1990s, partly encouraged by Malaysia's monopolised car sector, which soon led to Thailand emerging as the centre for automobile and auto parts manufacturing in Asia (Abdulsomad, 1998: 275-84). By 1995, half of all vehicles produced in Southeast Asia were made in Thailand.[69] Investors who had established or were planning to establish automobile plants in the country included the big names in the industry like Ford, General Motors, BMW, and Honda (Thailand, 2000: 12). Many of them were looking ahead to liberalisation of the automobile industry under AFTA that was

[68] These were removed in 2000 in line with Thailand's commitment to the GATT/WTO (Thailand, 2000: 7).

scheduled to begin in 2000 and were positioning themselves to exploit the regional market using Thailand as a production base.

Thus, Malaysia's move to temporarily withdraw automobiles from AFTA disciplines was a blow to automobile firms located in Thailand. Major foreign automobile players in Thailand began pressing the Thai government to ensure that AFTA remained on track for automobiles.[70] In fact, BMW's President, Karsten Engel, has said that the expansion of BMW's Thai plant will depend on the completion of the single AFTA market in automobiles.[71] The Malaysian automobile market was large, accounting for a quarter of total vehicle sales in the four core ASEAN countries (excluding Singapore) in 1996. The value of the Malaysian market to automobile manufacturers paradoxically increased as a result of the financial crisis, since large declines in vehicle sales in the other three countries meant that Malaysia's share of the regional market rose to about 42 per cent.[72] The Malaysian segment of the regional market in automobiles is, therefore, crucial to global automobile players who had set up in Thailand with an eye on the regional market.

The Malaysian auto industry: driven by domestic capital and multiple goals

Although Malaysia has long had a domestic car industry based on the assembly of foreign vehicles, the Malaysian Prime Minister Mahathir opted to develop an indigenous automobile manufacturing capability in the country through a national car project. Introduced in the early 1980s, it was part of Mahathir's heavy industries programme. Proton, the national car company, involved state capital while a minority equity stake was awarded to Mitsubishi of Japan, which provided the technical input. In the 1990s, a second

[69] *Malay Mail*, 'Cashing in on booming Thai mart', 28 September 1995.
[70] Interview with Mr Manasvi Srisodapol of the Ministry of Foreign Affairs, Thailand, August 2000.
[71] *NST*, 'BMW: expansion of Thai unit hinges on AFTA', 13 October 2000.

national car project was adopted called the Perodua, involving a mix of state capital, domestic private capital and foreign capital, notably through Daihatsu of Japan. The Perodua catered to the small passenger car segment, and thus did not directly compete with the Proton. Other national car projects involving Proton, ethnic Malay private capital and foreign investors such as Citroen of France were also encouraged. The national car industry developed through extensive state support that ranged from high import tariffs on competing products, direct and indirect financial assistance as well as government procurement (Tyndall, 1999: 4).

Despite the rapid growth of the national car industry, the multiple goals of the Malaysian national car project led to conflicts between the imperative of growth and efficiency on the one hand and the demands of distribution on the other. The industry had been established to accomplish three objectives. First, it was set up to promote the development of an integrated industrial sector with greater technological depth. Second, and related to the first objective, the project was part of Mahathir's vision to take Malaysia into the ranks of developed countries possessing an indigenous manufacturing and technological capability. Finally, the national car project was expected to catalyse the emergence of an ethnic Malay business community to fulfil the country's New Economic Policy goal of creating a Malay commercial and industrial class. Although ethnic Malay capital was involved in automobile manufacturing through the national car project, this was confined to the business elite with strong links to the political elite. The creation of a more extensive ethnic Malay business community was to be achieved through stimulating the growth of ethnic Malay automotive component suppliers to the national car project.

[72] Data calculated from information from the respective national automobile industry associations.

Distribution occurred at two levels. First, the preferential policies supporting the national car project, including the high tariff wall, redistributed income to the national car firms from existing producers, namely the local assemblers who were not part of the national car project and from consumers who had to pay exorbitant prices for car purchases. For instance, tariffs on CBU ranged from 140-200 per cent while tariffs of 42 per cent were slapped on CKD imports (Tyndall, 1999: 47). The national car project was also said to enjoy effective protection rates that were ten times that enjoyed by the non-national cars.[73] The resultant gains or rents were redirected to the national car project. At a second level, there was a further distribution of income, including monopoly rents, from the national car firms like Proton to the automotive component suppliers who were largely ethnic Malay.

The government had instituted a Vendor Development Programme (VDP) that required Proton and Perodua to procure component parts from domestic auto-parts suppliers. The VDP involved nurturing vendors, especially ethnic Malay vendors with little experience in the industry. It was the main vehicle to achieve the ethnic restructuring objective of the national car project, and it was responsible for increasing the proportion of ethnic Malay component suppliers in the country from 23 per cent in 1985 to 49 per cent by 1998 (Tyndall, 1999: 14). The national car firms, however, have had to share their considerable rents with their vendors by paying high prices for components, which were often of poor quality. The guaranteed market did not provide sufficient incentive for domestic vendors to improve efficiency, as they could still enjoy substantial returns. Although most auto parts were placed on the fast-track schedule of the CEPT, many vendors were not adversely affected as Proton and Perodua guaranteed purchase of the output from their official vendors (Tyndall, 1999: 14, 24).

[73] Interview with Mr Paramjit Singh Tyndall, Research Fellow at the Malaysian Institute of Economic Research in Kuala Lumpur, August 2000.

The Malaysian national car project and liberalisation

Even as early as 1995, market analysts predicted that the national cars would be unable to withstand global market competition and that early liberalisation was inadvisable.[74] The Malaysian government too failed to clarify its position on the industry's liberalisation schedule under the CEPT.[75] Moreover, Proton, Perodua and the auto-parts suppliers were all badly affected by the 1997 financial crisis due to the combined effects of the weakened ringgit, the reduced purchasing power and cautious attitude of consumers, and domestic credit tightening measures (Tyndall, 1999: 21). Although tariffs were raised in 1998 to help the industry cope,[76] it was clear that the government had to come to a decision with regard to CEPT liberalisation. Malaysia was due to lower CEPT tariffs on all products, including automobiles, to 20 per cent in 2000.

The ambiguous government attitude to tariff liberalisation of the automobile sector reflected the conflict facing the national car project. On the one hand, the Prime Minister's aim was not to nurture an inefficient, protected domestic auto industry but to create an export-oriented, efficient Malaysian auto industry that would be able to survive in the global market.[77] On the other hand, it was clear that AFTA liberalisation would pit Proton against the global automobile giants like Ford, General Motors, Honda, Toyota and Nissan, which had all set up or were planning to establish manufacturing plants in Thailand to supply to the ASEAN and wider Asian market. These players were also

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[74] *Investors Digest*, 'On the horns of a dilemma', 16 March 1995.
[75] *Business Times*, 'Automotive industry must be profitable on its own: PM', 24 September 1997.
[76] The 1998 national budget exercise raised import duties from 140-200 per cent on CBU to 140-300 per cent, and from 42 per cent on CKD to 42-80 per cent. See Tyndall (1999: 47). This further hurt domestic assemblers of foreign (non-national) vehicles.
[77] *Business Times*, 'Automotive industry must be profitable on its own: PM', 24 September 1997.

expanding their plants in Malaysia in the run-up to AFTA's completion.[78] Proton especially was not expected to survive what was effectively global market competition within a liberalised ASEAN market, nor in its home market[79] given its history of protected development.[80] Industry analysts predicted that Thailand's TNC-driven industry would have a competitive edge over subsidised industries like Proton, which would place Thai automobile firms well ahead of Proton with AFTA liberalisation.[81]

Although constantly castigating the national car firms to improve their efficiency and competitiveness and warning them that the government would not protect them indefinitely, the Prime Minister, nevertheless, acknowledged that temporary protection was necessary to develop an indigenous manufacturing capability in the country beyond mere vehicle assembly.[82] Dr Mahathir maintained that the Thai automobile industry was merely an assembly industry relying on foreign capital producing foreign cars and contrasted it with the Malaysian strategy of developing an indigenous technological and engineering capability in automobile production.[83] The dispute between Malaysia and Thailand over automobiles stemmed from the distinct nature of the industry in the two countries, with their incompatible priorities. Thailand emphasised growth and efficiency through foreign capital while Malaysia focused on nurturing domestic capital for both economic and political reasons, and thus emphasised both growth and distribution.

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[78] *Business Times*, 'Big boys are beefing up Malaysian operations', 4 July 2000.

[79] Market analyst Valuer Dresdner Kleinwort Benson projected a decline in Proton's share of the domestic market to about 30 per cent from 65 per cent in 2000 once the Malaysian market is liberalised under AFTA. See *Business Times*, 'Proton share of domestic car mart to shrink: study', 8 September 2000.

[80] Perodua, in contrast to Proton, was ready for a liberalised AFTA market. Perodua has the only plant in ASEAN producing small passenger vehicles of less than one litre capacity. The company, thus, had a niche market in ASEAN. Unfortunately, Perodua has had to toe the official line with regards to AFTA. Interview with Paramjit Singh Tyndall of the Malaysian Institute of Economic Research.

[81] *Bangkok Post*, 'Thai car industry a key to sustainable growth', 13 June 1997.

[82] *Business Times*, 'Automotive industry must be profitable on its own: PM', 24 September 1997.

Although both countries shared broadly similar goals for the CEPT – as a means to attract foreign capital to the region – differences emerged in the specific case of automobiles.

Despite delaying the liberalisation of automobiles in AFTA, it became clear that the Malaysian government was preparing for eventual liberalisation of the industry. Additional steps were taken to improve the efficiency of the national car firms. Proton expanded its programme to build up an in-house engineering capability by making plans to purchase a second foreign automobile engineering firm, this time from the US.[84] Proton's purchase in 1996 of an 80 per cent stake in British carmaker, Lotus Cars, had paid dividends. Proton had used the engineering capability of Lotus to develop its own proprietary engine, which was unveiled in 2000 at the Lotus plant in the UK. This development was expected to enable Proton to reduce its 15-year dependence on Mitsubishi for engines, thereby saving Proton about 25 per cent in costs.[85] Industry analysts also endorsed Proton's plans to sell the 1.3 litre and 1.6 litre petrol engine to other carmakers with assembly operations in the region, given the demand for inexpensive engines. The engine's modular design also meant that high volume production runs were not needed to recoup investment costs.[86]

Both Proton and Perodua also began global sourcing of component parts,[87] departing from their previous policy of obtaining high-cost supplies from their stable of domestic, especially ethnic Malay vendors. The VDP, which had been the key instrument to

[83] See *FEER*, 'Mahathir interview – 2', 24 June 1999. Also see *NST*, 'PM: Malaysia seeks delay in opening auto sector', 31 May 2000.
[84] *Financial Times*, 'Proton uses its delay in liberalisation to prepare for rise in foreign competition', 11 October 2000.
[85] *Ibid.*
[86] *Business Times*, 'S-ENG will give Proton more mileage', 9 October 2000.
[87] Interview with Mr Razak Ramli of the Malaysian Ministry of International Trade and Industry, August 2000.

implement the ethnic policy in the automotive sector, was clearly being placed on the backburner. This move suggests that the efficiency imperative had become dominant. This was reflected in the government's refusal to delay liberalising tariffs on automotive parts in AFTA, despite expectations by vendors that the government would protect them.[88]

Finally, and most interestingly, the Prime Minister agreed to allow Proton to sell a further equity stake in the company to foreign automobile firms, provided this was not more than 30 per cent.[89] Proton's need for foreign technical expertise to stay in the game, notwithstanding its ownership of Lotus, overcame Dr Mahathir's traditional resistance to the idea of selling Proton to foreign carmakers.[90] Sources revealed that two US auto firms had expressed interest in the deal – Ford and Daimler Chrysler.[91] This move suggests that the goal of developing an efficient and internationally competitive national automotive industry had become overwhelming, with the Prime Minister warning Proton that "we cannot protect you anymore".[92]

Failure of Proton, Mahathir's favoured project, would likely reflect badly on the Prime Minister and would add to the growing voices of opposition against him, especially in the ethnic Malay community. While it was clear that the need to emphasise the efficiency of Proton had become compelling, a pure growth/efficiency strategy that left outcomes to market forces was not adopted. The market was being kept in abeyance for a period of time through the CEPT delay to allow time for the national car project to try and meet international competitiveness standards, and thus to ensure its survival as well as vindicate Mahathir's vision of producing a Malaysian national car. This suggests, however, that the

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[88] *Business Times*, 'Local car part makers to face foreign competition', 8 September 1999.
[89] *NST*, 'Foreign firms to hold not more than 30pc stake in national car', 7 October 2000.
[90] *NST*, 'Attempts to take over Proton revealed', 19 July 2000.
[91] From *Associated Press*, 'Malaysia's Proton narrows search for partner', 9 October 2000.

two-year exemption from AFTA may well be extended if Proton's post-liberalisation survival remains in doubt.

6. Conclusion

This chapter confirms the second proposition advanced in the dissertation, namely that when the imperative of distribution became overwhelming, national governments chose to shield particular segments of domestic capital from regional liberalisation, including developmental regionalism. Despite the ambitious commitments that had been made to advance the regional project, and indeed despite the general success in implementing the CEPT, delays and difficulties were encountered in sectors like services, petrochemicals, agriculture and automobiles as a result of concerns with distribution. Fairly serious disputes emerged in agriculture and automobiles, often involving threats of retaliation and counter-threats, as member governments sought to re-negotiate their original commitments. These cases in particular clearly illustrate the sensitivities involved when regional liberalisation touched sectors in which domestic firms with strong ties to the political elite were dominant.

How member governments addressed these disputes is a question that has yet to be adequately answered in the literature. As the introductory chapter noted, many scholars not only expected such disputes to emerge in AFTA they also predicted that the disputes would lead to a breakdown of AFTA. This clearly did not happen, as the discussion so far shows. The next chapter attempts to answer this question by analysing how member governments attempted to rebalance the growth-distribution trade-off at the regional level, in the process ensuring AFTA's continuation.

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[92] *NST*, 'Gear up to face AFTA challenges, PM tells Proton', 17 February 2001.

CHAPTER 6

IMPLEMENTATION AS A POLITICAL PROCESS:

Taking Care of Growth and Distribution

1. Introduction

Although external pressures stemming from globalisation drove ambitious commitments in AFTA towards open and developmental regionalism, the previous chapter reveals that sustaining regionalism itself became an onerous task due to domestic political priorities that emphasised distribution over growth. The latter led to disputes among member governments, particularly over agriculture and automobiles that threatened to stall the AFTA project. Yet, AFTA did not collapse. This chapter focuses on how these conflicts were addressed at the regional level in ASEAN that enabled the cooperative process to proceed. The main argument advanced in the chapter is that implementation of AFTA became a political process, rather than merely a technical one of complying with commitments already made. Member governments bargained over implementation in order to address the growth-distribution tension within, and consequently between, member countries.

The analysis is located outside the globalisation-regionalism theoretical framework that framed the discussion in chapters 3, 4 and 5, with insights drawn from the IR literature on international cooperation. Much of this literature emphasises either the role of hegemonic power in maintaining cooperative processes or the role of institutions in sustaining cooperation (Keohane, 1989). Yet, AFTA has made significant advances in regional economic cooperation despite the absence of a regional leader and even though the institutional structures considered to be necessary to ensure implementation were not put in place when the project was initiated.[1]

The institutional argument is not rejected outright, however. The chapter takes the position that institutional structures can emerge out of the implementation process itself rather than simply prior to implementation, particularly in non-hegemonic settings. These emergent institutions, in turn, structure the game in ways that help to advance the cooperative process. This is one of the insights from the literature on compliance or post-agreement bargaining, which is well suited to explaining implementation in settings lacking a clear leader or hegemon, as in ASEAN/AFTA. Section 2 draws on this literature to advance an analytical framework to discuss implementation processes in AFTA. Section 3 uses two specific disputes in AFTA – over agriculture and automobiles – to analyse how implementation problems were addressed through compliance bargaining that led to both the downward revision of original commitments and institutional strengthening. Section 4 examines in some detail institution building processes in AFTA as an outcome of compliance bargaining using a framework of institutionalisation developed specifically for the dissertation.

2. Implementation as a Political Process: Theoretical Insights from the Literature on Compliance Bargaining and International Institutions

Compliance bargaining between states refers to all those bargaining and negotiation processes that follow from the conclusion of international agreements, a trend that is quite common in international negotiations (Jonsson and Tallberg, 1998: 376-97). This perspective recognises that a cooperative agreement does not solve all problems once and

[1] This is a common argument in the literature. See, for instance, Mattli (1999: 170-71) and Ravenhill (1995: 859).

for all, but instead creates a new bargaining situation once an agreement has been adopted. It provides useful insights on implementation as a political process, particularly with regards to what happens in the event of non-compliance. In compliance bargaining situations, bargaining strategies are adopted by both the 'guardians' and 'violators' of agreements to advance their respective positions during implementation. This is particularly true for self-help situations in non-hegemonic settings where a third party enforcer or prosecutor is absent, a situation that characterises ASEAN.[2]

In such settings, the managerial approach is likely to prevail in compliance bargaining processes rather than sanctioning approaches that regard compliance as an enforcement problem (Jonsson and Tallberg, 1998: 376).[3] The management school does not regard non-compliance as a deliberate decision by governments to violate an agreement.[4] Instead, it regards non-compliance as the outcome of ambiguities in the agreement, the limited technical capacity of governments to comply with the agreement, or unexpected social, economic or political developments that make compliance difficult to achieve (Chayes and Chayes, 1993: 188; Jonsson and Tallberg, 1998: 382-83).[5] The use of in-built sanctioning or punishment measures in agreements (the enforcement approach) is rejected in favour of managerial solutions, which emphasise persuasion or "jawboning" – the effort to persuade

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[2] Emmerson's assertion in the late 1980s that ASEAN is not a hegemonic system, but is characterised by balanced disparity (Emmerson, 1987) still holds today. Indonesia may be the largest country in ASEAN, but its dominant status by geographical, population and GDP size is balanced by the more advanced economic status of Singapore, Brunei and Malaysia, the three richest ASEAN countries in terms of per capita income levels.

[3] Works belonging to the management school are Chayes and Chayes (1993, 1995) and Keohane (1984). The enforcement school includes the work of Martin (1992) and Yarborough and Yarborough (1992).

[4] On the contrary, the enforcement school treats non-compliance as a deliberate decision by a member state to violate its commitments under the cooperative agreement. In this approach, cooperation is facilitated by the provision of effective enforcement and sanctioning mechanisms that deter potential violators. A study of 125 international treaties showed that sanctioning authority is rarely granted by treaty, rarely used when granted, and likely to be ineffective when used (Chayes and Chayes, 1995: 32).

[5] The last was clearly the main factor for non-compliance in AFTA, as Chapter 5 shows.

the violator to alter its behaviour (Chayes and Chayes, 1995: 25). Thus, compliance bargaining strategies adopted by treaty guardians may include persuasion in addition to or instead of threats to impose sanctions or the mobilisation of social and political pressure. The violator's main bargaining strategy may also consist of persuasion, apart from promises of rewards in return for tolerance of deviant behaviour or threats of retaliation.

In such instances, the search for mutually acceptable solutions might entail compromises that do not fully conform to the original agreement. This will be especially true when partners in the agreement lack the means of forcing violators into compliance, as in the case of ASEAN. In such instances, partners may decide to accept a lower level of compliance rather than risk the cooperative agreement in total (Chayes and Chayes, 1993: 184). Compliance bargaining processes generally also result in institutional strengthening. Apart from revisions to original commitments, members often attempt to enhance transparency of the cooperative process, tighten rules and procedures, and improve dispute resolution mechanisms in order to deal with non-compliance problems themselves (Jonsson and Tallberg, 1998: 375).

Compliance bargaining and institutions

Institutions work to advance cooperation in two ways. Martins and Simmons (1998: 739-42) identify informational and distributional models of institutions based respectively on the two central problems in international cooperation, namely how to prevent cheating and how to resolve distributional conflict.

Informational models stress the role of international institutions in providing information to participating governments to help overcome the fear of cheating that is regarded as the primary impediment to collaboration. Information improves transparency of government actions, thus facilitating the negotiation of cooperative agreements, the monitoring of agreements made, and allows compliance (or non-compliance) to be more easily observed. While the literature emphasises the primary audience to be other governments, this chapter suggests that informational institutions can also be directed at influencing non-state actors, business actors for instance, by signalling to the latter that the commitments made by governments are credible. Institution building is likely to be especially important when downward re-negotiation of the original commitments in compliance bargaining processes raise some doubts with regard to the future of the cooperative project.

Distributional models, on the other hand, address the problem of the unequal distribution of gains and losses between countries that impedes cooperation. Drawing on insights from legislative politics at the domestic level, particularly from the American experience, Martin and Simmons (1998: 741) argue that cooperation can be advanced through institutional structures that allow participants to link issues and cut deals with each other. This chapter modifies this argument and suggests that institutions emerging out of a process of bargaining that results in a lower level of compliance facilitate cooperation by allowing gains and losses to be traded between countries. Negotiating a lower level of compliance transfers gains to the violator from the offended party and from others for whom the original commitment was superior. In the process, the violating government is able to address domestic concerns with distribution. Nevertheless, all parties gain over the long run since this act allows a valuable cooperative process, AFTA in this case, to be maintained. The alternative may well have been the breakdown of the project.

The rest of this chapter fleshes out these arguments using the empirical material already presented in the preceding chapters, especially Chapters 2 and 5. The discussion focuses on how compliance bargaining processes that were set in motion by problems encountered during implementation of AFTA in turn led to both downward revisions to original commitments and institution building as member governments attempted to re-balance growth and distributive concerns at the regional level.

3. Compliance Bargaining in AFTA

Two of the most notable disputes in AFTA – over liberalising trade in agriculture and automobiles – arose out of problems certain member governments had with implementing commitments already adopted. This was discussed in the previous chapter. The discussion that follows reveals in greater detail how compliance bargaining processes were set in motion as a result of these disputes. Although bargaining was protracted, it eventually allowed the problem to be resolved, though at a lower level of compliance than the initial agreement. Nevertheless, these bargaining processes also led to institutional strengthening in AFTA.

3.1 Compliance Bargaining and Agricultural Trade Liberalisation

Indonesia triggered the dispute in ASEAN over agriculture when in early 1995 the Indonesian government backtracked on its earlier decision to liberalise trade in 15 unprocessed agricultural products by 2003. The said items, notably cloves, sugar, wheat and rice had initially been placed in Indonesia's temporary exclusion list in 1994, which would have required the government to liberalise trade in these items at the latest from 2000 and to remove associated NTBs. In early 1995, Indonesia transferred the 15 products to its sensitive list, which effectively provided indefinite protection for these items. The domestic political sensitivities associated with these particular items, discussed in the previous chapter, explain the Indonesian government's action on this issue and its subsequent refusal to budge from its original position.

Indonesia's move provoked a sharp response from Thailand, a major agricultural exporter. The Thai government then threatened to withdraw 44 agricultural products from AFTA in retaliation. After intense discussion, a compromise was finally reached later that year. The Eighth AFTA Council in December 1995 allowed Indonesia to shelter the 15 items until 2010 by creating a new temporary exclusion list specific to agricultural products.[6] To lend some order to this process, only agricultural items regulated by state-trading enterprises would qualify for inclusion in the new temporary exclusion list in agriculture, which was consistent with GATT/WTO practices. In fact, Indonesia had cited this particular GATT clause when it initially transferred the 15 products to its sensitive list.[7] The items excluded by Indonesia were regulated by state-trading agencies, namely BULOG for rice, sugar and wheat and the BPPC for cloves.

The Thai government was placated by the move, which would have extended the exemption period for these items, including the all-important rice, to 2010 instead of indefinitely as Indonesia had originally intended.[8] The Thai Finance Minister stressed that his government could "accept a lateral reclassification of the Indonesian products to another temporary exclusion category, but not a negative transfer of the items to Indonesia's sensitive list".[9] Unfortunately, the Indonesian officials at the meeting changed their minds only a day after the compromise had been adopted, and expressed reservations about meeting the new 2010 deadline.[10] The issue remained unresolved until the following April when the Ninth AFTA Council confirmed that the deadline for agricultural tariff liberalisation would remain January 2010. Member governments were, however, allowed

[6] See the *Joint Press Statement of the Eighth AFTA Council Meeting* held on 10 December 1995 in Bangkok.
[7] Interview with Ms Doojduan Sasanavin, Senior Policy and Plan Analyst with the Thai Ministry of Agriculture and Cooperatives, August 2000.
[8] *AWSJ*, 'ASEAN defuses trade dispute with Jakarta' 11 December 1995.
[9] *Ibid.*

to determine the ending tariff rates on those agricultural products in the parallel temporary exclusion list, which could be higher than 5 per cent.[11]

The Indonesian government was still keen to delay liberalisation of the fifteen items until 2020. The Philippine government, wishing to delay liberalising trade in rice and sugar, backed the Indonesian position. Both governments were reported as having refused to accept the 2010 deadline adopted by the Ninth AFTA Council.[12] Indonesia later declared, in September 1996, that it would agree to accept the 2010 deadline for all the said items, except rice and sugar that the government deemed to be 'highly sensitive' products. Indonesia wanted a 2020 deadline for CEPT liberalisation for these two items. This did not please the Thai government.[13]

This episode is clearly an instance of compliance bargaining in which the disputants, notably Thailand and Indonesia, employed both persuasion and threats. In the end, a compromise was reached when ASEAN member governments agreed to allow Indonesia until 2010 to finalise CEPT liberalisation of the 15 products it had initially withdrawn from AFTA. This represented a lower level of compliance over the original commitment, and was to Indonesia's benefit although the government still attempted to extend the exemption period to 2020 for sugar and rice. The compromise allowed Indonesia to preserve domestic monopoly arrangements involving firms and individuals with strong connections to the political elite. Indonesia's domestic distribution concerns were, therefore, addressed through compliance bargaining.

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[10] *AWSJ*, 'ASEAN fine tunes services liberalisation', 12 December 1995.
[11] *NST*, 'Council sets deadline for tariff reduction', 27 April 1996.
[12] *Business Times*, 'Officials deadlocked on farm issue', 11 September 1996; *Jakarta Post*, 11 September 1996.

Member governments, nevertheless, attempted to tighten up loopholes and introduced rules and procedures to govern the treatment of agricultural products. Negotiations continued for the next three years over the issue, which ended in the adoption of the *Protocol on Sensitive and Highly Sensitive Products* in September 1999. Indonesia classified only rice as a highly sensitive product in the Protocol, as did the Philippines and Malaysia, for which final tariff rates of between 0 and 20 per cent were due by 2010.

Thailand was, unfortunately the loser in the short term, since it could not export rice to Indonesia at preferential rates until 2010, and then only if Indonesia adhered to the Protocol. Thailand was compelled to compromise on the issue since AFTA had become a vital part of Thailand's economy. The AFTA market was vital to Thailand, second only to the US market in 1998.[14] Thailand was, therefore, unwilling to jeopardise the entire AFTA project by refusing to compromise over agriculture.[15] Thailand attempted to safeguard its growth priorities over the longer term by agreeing to compromise on this issue. Although the formal Protocol benefits Thailand by stipulating deadlines and ending tariff rates by all parties, it does not guarantee that members will adhere to them. Compliance by Indonesia has, nevertheless, been made easier by the crisis-induced domestic economic reforms that removed the monopoly interests behind much of Indonesia's response to agricultural trade liberalisation in the CEPT over the previous five years.

3.2 Compliance Bargaining and the Dispute over Automobiles

In early 1999, Malaysia requested that it be allowed to delay until 2005 the transfer of automobiles from the temporary exclusion list to the inclusion list, citing the problems

[13] *Jakarta Post*, 11 September 1996.

[14] While the US market took 22 per cent of Thai exports in 1998, almost 18 per cent went to the ASEAN-10 market, still a significant proportion given the crisis-induced recession in the region. Trade data was obtained from the IMF, *Direction of Trade Statistics Yearbook, 2000.*

experienced by Malaysia's national car project as a result of the 1997-98 financial crisis. All the ASEAN countries were dismayed by this development, particularly Thailand. The previous chapter shows how Thailand was poised to be the regional hub for foreign/global automobile producers planning to produce and export to the rest of ASEAN from Thailand if a free trade area in automobiles were in place. Like agriculture, this episode of compliance bargaining also involved threats of retaliation being made between Thailand and Malaysia, as well as persuasion and offers of rewards.

The dispute over automobiles was far more threatening to the core ASEAN countries than agriculture. Unlike agriculture, the automobile issue was more relevant to the creation of a single regional market for manufacturing activity, in which foreign investors in particular were interested. Moreover, Malaysia's delay request, made right in the throes of the financial crisis, raised questions among foreign investors about the future of the single regional market. The delay issue was a key item of discussion during the joint ASEAN investment promotion missions to the US and Europe in 1999-2000.[16]

Business leaders, particularly from the US and Japan, were understandably worried. American automobile firms, like their Japanese counterparts, had invested substantially in Thailand with the intention of exporting to the regional market once AFTA commitments in automobiles came into force from 2000. Gerald Kania, President of ASEAN Operations for Ford Motor Company warned that "implementation of AFTA is central to this region's ability to attract large-scale capital flows".[17] Other US firms in the telecommunications, air express and pharmaceutical sectors acknowledged that they were holding off investing further in the ASEAN region due to the automobile issue. These firms were also weighing

[15] Interview with the Secretary General of ASEAN, Mr Rodolfo Severino Jr.
[16] *Bangkok Post*, 'Group must get serious about backing free trade', 2 October 2000.

the benefits of committing their regional investments to China, which had re-emerged as an attractive investment site with its impending entry into the WTO.[18] Japanese firms with substantial investments in the ASEAN countries were also worried that Malaysia's move might open the floodgates with more members clamouring to withdraw other products from AFTA.[19]

Thailand, the country with the most to lose from Malaysia's move, began a series of bilateral discussions with the Malaysian government to seek a solution to the impasse, but these were unsuccessful. As in the case of agriculture, the Thai government was in a weak bargaining position. It was noted in the previous chapter that the Malaysian automobile market constituted the largest segment of the potential regional market for automobiles. For Thailand, an open Malaysian automobile market was, therefore, the superior option.[20] On the other hand, the Thai government had nothing to offer the Malaysian government as a quid pro quo.

Although the Thai government threatened to delay reducing tariffs on imports of palm oil products, a key export item for Malaysia, if Malaysia insisted on exempting automobiles, the Thai threat was ineffectual.[21] Malaysia's main export markets for palm oil products lay outside ASEAN, in Pakistan and China (Malaysia, 1998: xxvii). In an interesting twist, Malaysia reportedly lobbied the Thai government to delay liberalising tariffs on palm oil products so that it could proceed likewise for automobiles.[22] In the end, the Thai

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[17] *Business Times (Singapore)*, 'Why US firms find ASEAN less appealing', 6 October 2000.
[18] *Ibid.*
[19] Interview with Mr Kong Mun Pew of the Singapore Trade Development Board, August 2000.
[20] Interviews with Mr Rodolfo Severino Jr, and with Mr Karun Kittisataporn of Thailand.
[21] *The Nation*, 'Tariff reduction set despite Malaysia move', 30 September 1999.
[22] This was pointed out by Mr Cherdpong Siriwit, Director General of the Office of Industrial Economics, Thailand. See *The Nation*, 'Tariff reduction set despite Malaysia move', 30 September 1999.

government decided not to exclude palm oil products from CEPT disciplines, irrespective of the Malaysian position on automobiles.[23] This was for purely internal reasons, to avoid disadvantaging domestic food manufacturers who would have otherwise had to pay higher prices for palm oil inputs, although the mostly small farmers who produce palm oil were likely to be hurt by tariff reduction in this sector.[24]

The Thai government instead urged the Malaysian trade authorities to use the emergency safeguard clause in the CEPT to protect the automobile industry. Malaysian officials refused, however. Under the terms of the CEPT, the emergency safeguard clause could only be invoked if CEPT implementation caused injury to import-competing sectors.[25] In other words, the Malaysia government would have had to first liberalise automobile tariffs under the CEPT and then demonstrate injury to the domestic industry before it could use the safeguard provision. The Malaysian government was not prepared to do so, given the political importance of the national car project.[26] In the end, ASEAN economic and foreign ministers agreed to allow Malaysia to defer automobile tariff reduction. They had little choice, because Malaysian trade officials had made it clear that the government was prepared to leave the AFTA project if it's 'request' to delay tariff reduction on automobiles was not granted. Thai foreign minister, Surin Pitsuwan, admitted that if member governments did not acquiesce to the Malaysian demand, Malaysia "might say 'then to hell with AFTA'".[27]

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[23] *The Nation*, 'KL's AFTA decision would cause a schism', 25 October 1999.
[24] *The Nation*, 'Palm oil producers have most to lose', 22 October 1999.
[25] See Article 6 of the CEPT Agreement (ASEAN, 1992c). This was confirmed by a Malaysian trade official in a confidential interview.
[26] The explicit instruction of the Malaysian Prime Minister was to defer CEPT tariff liberalisation in automobiles only. No other sector was to be accorded the same privilege. Confidential interview with a Malaysian trade official.
[27] *Financial Times*, 'Malaysia trade exemption won through threat', 27 July 2000.

Although none of the ASEAN governments wished to scupper what had become a crucial economic project for them, and were therefore willing to go along with the Malaysian position, they were also keen to place the entire exercise within a rule-based framework to ensure the process was transparent and predictable. The ASEAN governments were especially keen to reassure business actors, particularly foreign investors that AFTA remained on track.[28] A decision was made to formulate a *Protocol on the Modification of CEPT Concessions* that would be based on GATT Article XXVIII and would incorporate a clause on compensation by the offending party.

While Malaysian trade officials rejected monetary forms of compensation, they were prepared to provide other forms of compensation including compensatory tariff reduction or technical assistance, which are also found in GATT Article XXVIII.[29] Thai trade officials admitted, however, that compensation was a second best offer for Thailand.[30] Malaysian tariffs were already low, while Thailand did not require development assistance. Nevertheless, the Thai government planned to ask for compensatory tariff reduction in agricultural commodities like sugar, rice and flour on which Malaysia retained high tariffs.[31] In any case, the compensation clause was inserted to also deter other governments in ASEAN from following the Malaysian example, and for whom compensation would significantly raise the costs of withdrawing from AFTA disciplines.[32]

ASEAN officials and ministers were sufficiently realistic to acknowledge that they have very little means of preventing any further delays by Malaysia in liberalising the

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[28] Interview with Mr Kong Mun Pew.
[29] Interview with Mr Karun Kittisataporn.
[30] Interview with Mr Karun Sittisataporn.
[31] *Business Times*, 'Malaysia under pressure over automotive sector duties rollback', 3 October 2000.
[32] Interview with Mr Karun Kittisataporn.

automobiles sector under AFTA, even though the Protocol aims to raise the costs of doing so through rule building.[33] Although member governments have little rule enforcement powers apart from diplomacy, they were clearly attempting to limit new requests for delays from members through the Protocol by making the process of modifying concessions sufficiently restrictive and costly to members. In doing so, they were attempting to ensure that the conditions for growth were maintained in AFTA, while also enabling a fellow member to address its particular concerns with domestic distribution.

4. Institution Building in AFTA: An Outcome of Compliance Bargaining

The outcome of bargaining over implementation in both the agriculture and automobile cases led to the downward revision of commitments from those previously agreed. Conversely, they also led to a process of institutional strengthening. Specifically, the adoption of the *Protocol on Sensitive and Highly Sensitive Products* in the case of agriculture and the *Protocol on the Modification of CEPT Concessions* in the case of automobiles both involved inscribing rules and procedures. Rules and procedures constitute a key dimension of institutionalisation, acting to constrain the future actions of member governments and to provide greater transparency in cooperation. These functions are important not only to convince other governments in the project to continue cooperation they are also useful in convincing non-state actors, investors for instance, that the regional project remains viable.

In fact, these two protocols were part of a broader process of institution building in AFTA that took place throughout the 1990s triggered by problems and setbacks with implementation. The discussion that follows examines in greater detail the process of institutional strengthening in AFTA, first by developing a more precise framework to

[33] Interview with Mr Kong Mun Pew.

characterise institutions, which is then used to assess the extent of institution building in AFTA.

4.1 A Framework to Characterise Institutions

There is, thus far, no study that has determined the nature and extent of institution building associated with AFTA. Although scholars like Acharya (1998: 212) and Henderson (1999: 23) point out that AFTA appeared to involve a greater degree of formality and institutions than other cooperative activities in ASEAN, the precise nature of these institutions has not been established.[34] This is a necessary task, since the compliance bargaining framework adopted in the chapter sees institution building as one of the two key outcomes of bargaining over implementation. Before an empirical assessment can be made of whether AFTA was indeed accompanied by a process of institutional strengthening, it is necessary to develop a baseline or ideal-typical model of strong and weak institutions. Such a model is presented in Table 6.1.

Those studying institutional structures relevant to economic cooperation in ASEAN tend to regard institutions as synonymous with organisational structures, and thus focus extensively on administrative structures as well as decision-making hierarchies.[35] While organisational structures clearly have a role to play in facilitating the establishment and implementation of cooperative agreements, institutions are best seen as something more than formal organisations that possess "personnel, budgets, and physical structures".[36] Instead, international institutions are best conceptualised as "persistent and connected sets

[34] This chapter's study of institutionalisation in ASEAN/AFTA is the first such study of this nature. A modified version of this chapter has been published as Nesadurai (2001).
[35] See Chng (1991) and Pelkman (1992).
[36] See Young (1989: 25).

of rules (formal and informal) that prescribe behavioural roles, constrain activity and shape expectations" (Keohane, 1989: 3).

Existing studies of regional institutions in general also adopt a limited approach to characterising institutions, focusing on one or two dimensions of institutionalisation. Many of them, for instance, emphasise the extent to which supranational structures are present (Grieco, 1997; Mattli, 1999). Others emphasise the dimension of strength, by which they mean the degree of compliance with institutional injunctions (Enia and Karns, 1999). This approach, however, confuses institutional structures with outcomes. A better approach is to focus on institutional design and the theoretical constraints this imposes on institutional members (Kahler, 1995: 3).[37] This is the approach this chapter adopts in constructing the typology of institutionalisation, which is based on four dimensions (Table 6.1).[38] The nature of the theoretical constraints imposed on institutional members as a result of these four different dimensions of institutionalisation is discussed below.

Each dimension of institutionalisation is presumed to vary in two ways, respectively reflecting low and high levels of institutionalisation. If institutions are defined as sets of practices, rules and procedures that constrain activity, shape expectations and prescribe acceptable forms of behaviour, then by definition a higher level of institutionalisation involves stronger constraints on, as well as more explicit prescriptions for, national behaviour. The task is simply to determine whether there was a shift from lower to higher levels of institutionalisation in AFTA, or institutional strengthening, which represents one

[37] This is not to imply any causal relationship between institutional design and institutional strength on the one hand and compliance on the other. Kahler cautions against 'naïve institutionalism', namely that dense institutional settings generate successful cooperation (Kahler, 1995: 131-33).
[38] The chapter uses insights from Padoa-Schioppa (1985), Lipson (1991), Kahler (1988, 1995) and Grieco (1997) to develop its typology of institutionalisation.

of the outcomes of compliance bargaining. Discussion on the effectiveness of these institutional forms in ensuring compliance is beyond the scope of the dissertation.

Table 6.1

A Framework of Institutionalisation

Dimensions of Institutionalisation	**Level of Institutionalisation**	
	Low	**High**
Nature of Constitutional Documents		
• Degree of formality	Informal;	Formal;
• Nature of commitments	Non-binding;	Binding;
• Form of the agreement	Joint communiqué or vaguely worded statement of intent;	Detailed agreement;
Decision-Making Procedures		
• Voting style	Consensus;	Majority voting or partial easing of consensus requirements
Modality of Cooperation		
• Substantive policy targets (rules)	Absent or ambiguous;	Present and transparent;
• If present:	Nationally determined;	Multilaterally/jointly determined;
• Procedural rules	Absent or ambiguous;	Present and transparent;
Nature of Coordination		
• Decision-making	Ad-hoc or crisis-driven;	Regularised and/or centralised;
• Monitoring	Decentralised/Inter-governmental;	Third-party/centralised;
• Enforcement	Decentralised/Inter-governmental;	Third-party/centralised With delegated powers;

Source: Nesadurai (2001: 203)

Nature of the Constitutional Documents

Three features of the constitutional documents underpinning regional cooperation are relevant to the discussion – (a) the extent of their formality, (b) whether they are binding on signatories, and (c) the form that such agreements take, whether they are elaborately written documents, joint communiqués, verbal commitments or even tacit (unwritten) bargains.

A formal agreement is defined as one that enjoys the state's most authoritative imprimatur, namely ratification (Lipson, 1991: 498). Institutions governed by informal agreements are presumed to reflect a lower level of institutional constraint on national governments compared to those based on formal agreements. This is simply because informal agreements can be more easily abandoned at lower cost than formal agreements, although this is not always the case in anarchic international settings (Lipson, 1991: 508-9). Although informal agreements do not necessarily preclude cooperation, the language of 'binding commitments' that is found in formal agreements are instances of diplomatic communication aimed at other signatories or third parties, revealing states' intentions, at least, to adhere to a particular commitment (Lipson, 1991: 508). Similarly, a higher level of institutionalisation is associated with cooperative agreements that stipulate binding commitments over non-binding ones, while detailed agreements that are clear and transparent are also presumed to reflect higher levels of institutionalisation. Compared to vaguely worded agreements or simple joint statements of intent, detailed agreements that are clear and transparent impose a larger constraint on signatories than the former, since they specify more clearly promises about future national behaviour.

The institutional constraints provided through formal, binding agreements that are detailed, clear and transparent work by raising the costs of non-compliance. These costs are incurred largely in terms of loss of reputational capital if parties are seen to be reneging on 'binding' agreements to which they had committed themselves, making future cooperation less likely as other governments become increasingly wary of engaging in cooperation with the recalcitrant partner. In the case of economic agreements designed to influence economic actors, reneging on such agreements by governments also carries with it economic costs if economic actors decide not to engage in the economic activity the agreement was designed to promote due to the lack of credibility of participating governments.

It is also important to remember that international agreements are often designed to be flexible, since governments, often being uncertain about the distribution of future benefits under a particular agreement, are naturally reluctant to conclude long-term, inflexible agreements (Lipson, 1991: 518-19). International agreements are often designed to allow signatories to partially withdraw without risk to reputations, a prime example being the GATT escape clauses that allow for post-agreement protection.[39] While this chapter accepts flexibility as an important attribute of institutions, flexible agreements in which caveats or escape clauses are well-defined and clearly expressed, including the conditions under which they can be invoked, are presumed to reflect a higher level of institutionalisation.

Decision-Making Procedures

Decision rules within institutions can affect the constraints that an institution imposes on its members. Consensus decision-making allows the party least inclined to accept constraints on its behaviour to veto other parties that are willing to accept more stringent constraints. Mechanisms such as majority voting, easing consensus requirements for particular decisions, delegating responsibilities to technical experts, and setting clear time limits for particular procedures, especially in dispute settlement (Kahler, 1995) are assumed to reflect a higher level of institutionalisation. Consensus decision-making in this chapter is therefore associated with weaker constraints on national behaviour.

[39] Kahler has, in fact, attributed the success of the GATT to such flexibility. See Kahler (1995: 24-26).

Modality of Cooperation

Coordination within an institution can follow substantive or procedural rules (Kahler, 1995: 4). Substantive institutions feature explicit and detailed rules on substantive policy targets, such as maintaining a fixed exchange rate, an ending tariff rate, the date by which a particular tariff rate has to be reached, or a precise timetable for tariff reductions. Procedural institutions feature a set of procedural rules that are used to suggest a course of action under certain specified conditions.

At one level, the presence of explicit or detailed rules and injunctions, or substantive policy targets, is assumed to reflect a higher level of institutionalisation since the degree of constraint imposed on members will be higher in such instances. At a second level, institutions in which rules are jointly determined rather than decided unilaterally by each member are presumed to represent a higher level of institutionalisation. When national governments are allowed to determine policy targets unilaterally, they are not obliged to consider joint gains for the system as a whole. Jointly determined rules are expected to impose a higher degree of constraint upon members relative to unilaterally determined targets since it is assumed that the former will consider the needs of the system as a whole (Padoa-Schioppa, 1985: 266-68). Nevertheless, the presence of consensus decision-making qualifies this argument since then, a party unwilling to accept a higher degree of constraint on its behaviour will be able to determine the agenda for all members.

This chapter also considers the presence of procedural rules to reflect a higher degree of institutionalisation, since such rules compel members to adopt a course of action in the event of disruption or potential disruption to cooperation. Thus, procedural rules may trigger either dispute settlement processes or at least an obligation for members to consult each other to address problems that arise in the course of cooperation. In such instances, institutional members must, at the very least, jointly consider or debate any departures from the cooperative agreement.

Nature of Coordination

The three key aspects of institutional coordination, namely decision-making, monitoring and enforcement can vary along the centralised – decentralised continuum, reflecting respectively higher and lower levels of institutionalisation. Stronger institutions are defined as those that display regularised or centralised decision-making in which decisions on collaboration are made jointly rather than on an *ad-hoc* basis or only when crises strike. Regularised decision-making raises the chances for cooperative outcomes over purely *ad-hoc* forums, since the former raises the 'shadow of the future' (Axelrod and Keohane, 1985).

Decentralised or inter-governmental monitoring and enforcement are assumed to reflect weaker institutions compared to third party or centralised arrangements provided with delegated or independent powers. The former raises the possibility that institutional constraints on behaviour may be negotiated downwards through inter-governmental compromises. Third party arrangements like panels of technical experts rarely allow for the downward re-negotiation of institutional commitments. Instead, such panels usually uphold institutions by providing rulings on whether institutional commitments have been breached and often also specify the countervailing actions that need to be taken in the event of such breaches. The effect of such panels on behavioural outcomes depends on the way panel results are treated within the institution, however.

4.2 Institution Building in AFTA: Nature of the Constitutional Documents

Apart from the initial agreements made among the ASEAN governments in 1992 that launched AFTA and the Summit Declarations of 1992, 1995 and 1998, all other agreements signed between the ASEAN member governments are formal and binding requiring domestic ratification by national legislatures. Table 6.2 shows a progressive increase in the level of institutionalisation associated with AFTA when we focus on the nature of its constitutional documents.

Table 6.2

Nature of the Constitutional Documents

Agreements (signed)[a]	Degree of Formality[b]	Type of Commitments[c]	Form of Agreement[d]
Framework Agreement on Enhancing Economic Cooperation (28-1-92)	Informal	Not clearly stated	Vague; Few specifics
Agreement on the Common Effective Preferential Tariff Scheme for AFTA (28-1-92)	Informal	Not clearly stated	Some details provided
Protocol to Amend the Framework Agreement on Enhancing ASEAN Economic Cooperation (15-12-95)	Formal	Binding	Completion period set at 10 years; Allows for accession of new members
Protocol to Amend the Common Effective Preferential Tariff Scheme for AFTA (15-12-95)	Formal	Binding	More details provided than original CEPT Agreement
ASEAN Framework Agreement on Services (15-12-95)	Formal	Binding	Statement of Intent
Protocol on Dispute Settlement Mechanism (26-11-96)	Formal	Binding	Detailed procedures provided
Protocol to Implement the Initial Package of Commitments Under ASEAN Framework Agreement on Services (15-12-97)	Formal	Binding	Commitment details provided in annexes
Framework Agreement on the ASEAN Investment Area (8-10-98)	Formal	Binding	Statement of intent, providing procedures for future negotiations
Protocol on Notification Procedures (8-10-98)	Formal	Binding	Detailed procedures provided
Protocol to Implement the Second Package of Commitments Under the ASEAN Framework Agreement on Services (16-12-98)	Formal	Binding	Commitment details provided in annexes

Protocol on the Special Arrangement for Sensitive and Highly Sensitive Products (30-9-99)	Formal	Binding	Substantive targets and procedures outlined
Protocol Regarding the Implementation of the CEPT Scheme Temporary Exclusion List (23-11-2000)	Formal	Binding	Detailed procedures provided on modification of CEPT concessions

[a] Other agreements signed but excluded from this table are the three Summit Declarations (1992, 1995, 1998), agreements on intellectual property rights, facilitation of goods in transit within ASEAN, industrial cooperation, customs harmonisation, electronic commerce, and mutual recognition arrangements; [b] Ratification is required for formal agreements while informal agreements do not require ratification; [c] Whether binding or non-binding; [d] Whether detailed or vaguely worded/statement of intent;

All agreements/protocols relating to AFTA and economic cooperation are available from the ASEAN Secretariat web-site at www.asean.or.id

It was noted in Chapter 2 that the original AFTA agreements of 1992, namely the Framework Agreement and the CEPT Agreement, provided few specific details. Member governments quickly returned to the negotiating table to work out the necessary rules and procedures to govern the workings of AFTA in general, and the CEPT in particular. Moreover, protocols on procedural matters were also adopted, notably on dispute settlement in 1996, on notification procedures in 1998, and on modification of CEPT concessions in 2000.

The key point to note is that from 1995, the constitutional documents underpinning AFTA became formal and binding on signatories, while the level of detail provided also increased. This represented one dimension of the increasing institutionalisation of AFTA. Moreover, for services and investment, initial statements of intent in the form of framework agreements were followed by negotiations to firm up commitments. Contrary to popular perception, this approach to AFTA – cynically dubbed Agree First Talk After[40] – is not unique to AFTA. Many international agreements are developed from general

[40] According to Narongchai Akrasanee, a prominent Thai corporate executive and a long-time advocate of closer economic cooperation in ASEAN (Baldwin, 1997: 55).

framework agreements that move to become increasingly specific protocols through a sequence of bargaining processes (Jonsson and Tallberg, 1998: 372).

4.3 The Institutional Mechanism for Decision-Making

Consensus decision-making operates in AFTA at all levels, resulting in a weakly institutionalised AFTA as far as this dimension is concerned. A simple majority voting procedure is, however, incorporated within the dispute settlement procedure outlined in the *Protocol on Dispute Settlement Mechanism.* Thus far, the DSM has yet to be invoked, with member governments preferring to engage in negotiations among themselves to resolve disputes.

4.4 Institution Building in AFTA: Coordination through Rules and Procedures

ASEAN member governments engaged in the progressive tightening of rules and procedures in AFTA since 1992, but especially in the period after 1995. These rules and procedures covered a range of issues, including how to conduct future negotiations, schedules for tariff liberalisation, modification of concessions already made, dispute settlement and notification procedures, emergency safeguards, and how to treat exemptions. Substantive policy targets and procedural rules were made more transparent while new rules and procedures were introduced where previously none existed. While flexibility continues to be a feature, the conditions governing flexibility were made more transparent and stringent. Clearly AFTA has undergone a gradual process of institutionalisation through rule building since its inception.

Strengthening rules and procedures: general CEPT implementation

Although some policy targets were initially indicated in AFTA for the liberalisation of goods trade, these were not clearly specified, with individual member governments able to determine their respective rates of reduction within the end tariff rates and the 15-year time period stipulated in the original CEPT Agreement.[41] Annual tariff reduction schedules were thus nationally rather than jointly determined. Moreover, no clear procedures governed the treatment of exclusions. In 1994-95, ASEAN member governments introduced and tightened rules and procedures for the CEPT that set a common date for commencing tariff liberalisation, as well as stipulated how tariffs on products in the TEL would be liberalised. Although the specifics of tariff liberalisation were nationally determined, such as the particular commodities to be liberalised and their respective rates of tariff reduction, some regularity and transparency was introduced by stipulating common start and end dates and by the obligation for member governments to issue annual tariff reduction packages.

Strengthening rules and procedures: unprocessed agricultural products

It was noted above that the ASEAN member governments undertook to formally tighten rules and procedures for the temporary exclusion of unprocessed agricultural products by signing a *Protocol on Sensitive and Highly Sensitive Agricultural Products* in September 1999 (ASEAN, 1999). The Protocol stipulates that the original six ASEAN members were to begin phasing into the CEPT scheme agricultural products on their sensitive lists between January 2001 and January 2003. The deadline was set at 2010 when tariffs on these products would have to be at the 0-5 per cent range. Highly sensitive products were to be phased in beginning anytime between January 2001 and January 2005, but with phasing in to be completed by January 2010. Indonesia, Malaysia and the Philippines were the only countries to submit a list of highly sensitive products, essentially rice and rice-related products. They were allowed the flexibility to determine the final tariff rates for these products, although the Protocol capped this at 20 per cent.

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[41] See Chapter 2 (Section 2.1).

Establishing procedures for dispute settlement

The 1992 CEPT Agreement did not include any mechanism for dispute settlement, only specifying in Article 8 that member states should try to amicably settle any disputes arising from implementation of AFTA through consultations. In November 1996, ASEAN member countries adopted a *Protocol on Dispute Settlement Mechanism* (ASEAN 1996b). Comprising 12 Articles, this Protocol specifies in some detail the procedures that member governments need to follow in the event of a dispute.

Thus far, the DSM has yet to be invoked, although a number of disputes have arisen in the course of AFTA. ASEAN member governments preferred to address these disputes through diplomatic consultations and bargaining. Senior officials from Indonesia, Singapore, Thailand and Malaysia interviewed by the author between July and September 2000 reiterated that invoking the DSM could jeopardise political relationships in ASEAN, something that all member governments wished to avoid. Nevertheless, a DSM was established to at least make available a framework of procedures and rules in the event it became needed.[42]

Although the member governments' preference for diplomatic consultations to resolve disputes in AFTA seemingly reflects an Asian cultural aversion to legalistic forms of cooperation,[43] the cultural argument should not be exaggerated. The evidence in this chapter suggests that the ASEAN governments were not averse to adopting more formal rules and procedures to guide regional economic cooperation. Kahler (1995: 99), moreover, notes that a preference for diplomacy in dispute resolution exists in many

[42] Interview with Mr Razak Ramli, Malaysia, August 2000.
[43] See Ravenhill (1998: 159).

international forums. The European experience in the European Free Trade Area (EFTA) is strikingly similar. Although a Ministerial Council had been established in EFTA to rule on disputes between members, only very minor conflicts were brought to the Council for resolution. Major disagreements between EFTA members were settled bilaterally or multilaterally through consultation so as not to jeopardise the political relationships between these countries (Curzon, 1974: 51-55).

Specifying notification procedures

The original CEPT Agreement did not provide details on procedures to be adopted should members wish to nullify the concessions they originally offered to regional partners (ASEAN, 1992c). The Notification Protocol adopted in 1998 attempted to address this gap in AFTA (ASEAN, 1998b). Its adoption creates a more predictable and rule-based AFTA, as member governments and economic actors can now be warned in advance of possible changes to AFTA concessions.

Member governments decided to adopt such a procedure largely in response to Indonesia's actions in raising import tariffs on a number of petrochemical items in 1996 and 1997 without informing other members or the ASEAN Secretariat.[44] This created problems for firms in the other ASEAN countries who were unaware of the alteration until actually confronted with the new rates at Indonesian customs borders. The Malaysian government threatened to lodge a complaint against Indonesia at the WTO over the latter's intransigence over petrochemicals. Supported by the other members, Malaysia pushed for the adoption of a Notification Protocol to limit similar developments in the future.[45]

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[44] See the discussion on Indonesia and petrochemicals in Chapter 5.
[45] *Jakarta Post*, 16 October 1997.

Introducing procedures for the modification of CEPT concessions

The ASEAN economic ministers signed a Protocol in November 2000 that provides rules and procedures to govern a more flexible implementation of the CEPT. The Protocol, closely based on Article XXVIII (Modification of Schedule) of the GATT 1994, was developed in response to Malaysia's request that it be allowed a two-year delay in shifting automobiles into the inclusion list and subjecting them to CEPT tariff reductions. The Protocol enables member governments facing real economic difficulties to delay the transfer of a product from the temporary exclusion list to the inclusion list or to temporarily suspend concessions on products already transferred to the inclusion list (ASEAN, 2000). Modifications were, however, limited to the final tranche of temporary exclusion list products moved to the inclusion list on 1 January 2000. The Protocol also provides for compensatory adjustment from the offending party to other members on a most-favoured nation (MFN) basis through Article 5. Article 6 specifies procedures to adopt in the event of non-agreement on compensation.

4.5 Institutional Mechanisms and Modes of Coordination

Decision-making, monitoring and enforcement in AFTA remain decentralised, revealing ASEAN's preference for inter-governmental mechanisms as opposed to third party or centralised modes of coordination. This approach to cooperation is, however, not unique to ASEAN (Kahler, 1995: 121).

Decision-making in AFTA occurs at three principal levels, namely the senior economic officials meeting (SEOM), the economic ministers meeting (AEM) and the leaders' summits. Prior to 1995, leaders' summits were held infrequently, with only four held between 1967 when ASEAN was formed and 1992. In 1992 at the Singapore Summit, the leaders decided to regularise their summits, agreeing to hold formal summit meetings once every three years. At the Bangkok Summit in 1995, ASEAN leaders agreed to meet annually on an informal basis to help advance AFTA. Thus, leaders now meet either formally or informally at least once each year.

The AEM meets at least twice annually, once formally and the second time informally. Between July 1998 and June 1999, the AEM, in fact, met six times. The SEOM meet more frequently each year, with 11 such meetings held between July 1998 and June 1999 (ASEAN Annual Report, 1998-99: 113). The AEM and SEOM meetings involve serious negotiations, consultations and ultimately decision-making on outstanding issues, including implementation issues. The process can be cumbersome and time consuming though, with issues on which decisions are difficult to reach transferred to the higher level meeting. Nevertheless, there clearly is a commitment to working through problems and outstanding issues in AFTA rather than avoiding or deferring them altogether, a charge sometimes levelled at ASEAN.

Monitoring is also carried out in a decentralised manner, with firms and national governments providing the main source of information on implementation problems in AFTA. Firms may notify the AFTA Units located within each national government or directly to the AFTA Unit in the ASEAN Secretariat of any problems they may have experienced with regard to impediments to AFTA. Enforcement is also decentralised, with the SEOM or the AEM the final arbiters on disputes. In addition, the ASEAN Secretariat has itself been tasked with the overall monitoring of all aspects of AFTA, although the Secretariat has no sanctioning powers.

Although coordination in AFTA is carried out in a decentralised manner, the inter-governmental mechanisms for decision-making, monitoring and enforcement are well institutionalised rather than being ad-hoc or crisis-driven. At the very least, they provide an institutionalised arena for negotiations and bargaining that have helped to advance the AFTA process on many occasions. This does not always guarantee that decisions made in such forums will always hasten implementation of AFTA. On a number of occasions, these institutionalised mechanisms have served as the arena where compromises were worked out resulting in a lower level of compliance. Nevertheless, as all ASEAN senior officials and scholars of ASEAN interviewed between July and September 2000 have pointed out, it is unlikely that AFTA could have advanced as far as it has done without these compromises.[46]

4.6 Compliance Bargaining and Partial Institution Building in AFTA

It is clear that partial institution building took place in AFTA throughout the 1990s, especially from 1995. While consensus decision-making and the decentralised nature of coordination limited the constraints imposed on member governments, the tightening of existing rules and procedures as well as the articulation of new rules and procedures to govern issues where none existed previously strengthened the institutional foundations of AFTA. These rules and procedures were articulated through fairly detailed, binding protocols that required domestic ratification. The AFTA process also included clear agendas for negotiations as well as negotiated timetables. While flexibility was maintained, the conditions governing flexibility were made more transparent and stringent. Although decision-making, monitoring and enforcement remained decentralised, decision-making processes were increasingly regularised, particularly at the level of leaders' summits.

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46 Stubbs makes a similar point on the value of compromises, although he argues that this was primarily the result of the regional political culture, namely the 'ASEAN Way'. See Stubbs (2000: 312) and the discussion in Section 2.3 in the introductory chapter. I prefer an interest-based rather than a cultural argument.

Institutional strengthening in AFTA, notably through rule building, was a process phenomenon, the outcome of compliance bargaining. When problems emerged among the ASEAN countries on particular AFTA agenda items, a process of negotiations and bargaining between these countries was set in motion. The presence of regularised inter-governmental mechanisms for decision-making – such as the meetings of senior officials, ministers, and leaders – facilitated this process by providing an institutionalised arena where negotiations could take place. While persuasion was the principle means employed to resolve problems, threats of retaliation were also used by one or another ASEAN member government, in a clear departure from the 'ASEAN Way' of inter-state relations.

5. Conclusion

This chapter uses the compliance bargaining framework together with insights from the literature on international institutions to develop the dissertation's third proposition – that implementation was itself a political process that attempted to take care of both growth and distributive concerns in AFTA. The discussion shows that this was accomplished through bargaining processes that attempted to address non-compliance with AFTA commitments. Two outcomes resulted. First, bargaining generally led to a re-negotiation of the original commitment and the adoption of revised, lower targets. This took care of the domestic distributive concerns of affected member countries, and thus, prevented the collapse of the entire project. Second, partial institution building occurred, largely through the tightening of rules and procedures in AFTA. The latter raised the costs to members of reneging on their original and re-negotiated AFTA obligations. They also signalled to business actors, notably foreign investors, that AFTA remained a credible project despite the re-negotiations and setbacks.

This processes of compliance bargaining allowed the ASEAN member governments to resolve disputes between themselves over particular AFTA agenda items. Although a lower level of compliance prevailed than the original commitments would have entailed, nevertheless intra-ASEAN tensions were diffused. The ASEAN Secretary General, Mr Rodolfo Severino, Jr. used the metaphor of 'safety valves' to illustrate the role played by such processes.[47] Compromises were necessary in AFTA because they helped to defuse the tensions that often emerged due to divergent domestic political priorities, but they also helped to advance the regional project as a result. Far from being the product of regional cultural norms, these processes of working out a modus vivendi were driven by the respective interests of member government in creating a balance between the imperatives of growth and domestic distribution. It was clearly not an ideal arrangement for all members, particularly Thailand, but it was the best available under the circumstances that allowed the core ASEAN governments to maintain what was for them a valuable project of economic regionalism.

[47] Interview in July 2000.

CONCLUSION

This study began with three empirical questions. (i) Why did the ASEAN countries, already committed to open trade and investment regimes since the end of the 1980s and which were already trading extensively worldwide and participating in international investment flows engage in forming a regional free trade area? (ii) How are we to interpret the discriminatory treatment between ASEAN and non-ASEAN investors in the regional investment liberalisation programme, if AFTA was adopted as a tool to help attract global investment capital? (iii) What accounts for the subsequent shift to a more cautious programme of liberalisation in sectors like agriculture, petrochemicals, automobiles and services?

To briefly summarise, the study leads one to conclude that AFTA encompassed two forms of regionalism, both of which were stimulated by the forces of globalisation that the core ASEAN economies were confronted with during the 1990s. On the one hand, the CEPT programme to liberalise trade in goods was an exercise in open regionalism, designed to attract globally mobile foreign capital to the region. On the other, the investment liberalisation programme displayed the features of what I call 'developmental regionalism', designed to nurture the development of domestic capital in anticipation of global market competition by according domestic investors temporary privileges ahead of foreign investors. Nevertheless, domestic concerns with distribution sometimes overwhelmed the concern with growth that had driven the turn to both open and developmental regionalism, and consequently led to departures from some of the original commitments that were made. This made implementation of AFTA commitments a political process, rather than merely a technical one, and involved a great deal of negotiations and bargaining that sought to balance the growth priorities of member governments with their concerns with domestic distribution.

Globalisation and AFTA: mediated by the domestic political economy

Both open regionalism and developmental regionalism were stimulated by the structural forces of globalisation, and were ultimately about engaging with these forces. Structural change in the pace, nature and pattern of global investment flows led to fears in the region about the possibility of investment diversion to other parts of the world, most notably to China. This was a major concern among ASEAN leaders and policymakers during the 1990s, providing the primary stimulus to adopting and sustaining AFTA as a project of open regionalism.

The shift in global capital flows was not the only systemic force impinging on these countries. Globalisation manifested itself in other ways as well, through changes in its institutional underpinnings and as an emerging hegemonic cognitive structure. The ASEAN member countries were confronted with the possibility that new multilateral rules would be written to allow TNCs maximum freedom of operation in all countries, particularly through the WTO that was already endowed with increased authority and responsibilities in new issue areas. ASEAN leaders and policymakers also perceived an unrelenting globalisation centred on intense international competition involving global/foreign firms. While these additional forces of globalisation did, to some extent, reinforce open regionalism in ASEAN as an instrument to attract global capital flows, they also raised additional concerns in some countries with regard to the future of domestic capital, particularly of politically important business actors. Chapters 3 and 4 discussed these arguments in detail.

Although domestic capital was important in all the core ASEAN countries, it was especially important in Malaysia and Indonesia, often enjoying close political relationships with incumbent political elites and thereby helping to sustain elite coalitions and the stability of the prevailing regime. Concern over the future of domestic firms in global market competition was, therefore, especially pronounced in Malaysia and Indonesia, which respectively advocated and actively supported the idea of using regionalism as a developmental tool to preserve the future of domestic firms amidst impending global market competition. The idea of developmental regionalism was especially salient in sectors outside manufacturing, particularly in the category termed 'services incidental to manufacturing'. None of the other ASEAN countries challenged the idea, since there was little conflict between the FDI dynamic of regionalism and the developmental dynamic. The former was centred on the CEPT and the latter on the AIA. Developmental regionalism, moreover, did not contradict the interests of the other ASEAN governments, particularly in Singapore and Thailand, which was to create the conditions for Singaporean and Thai domestic capital to expand through regionalism.

Thus, the ASEAN member countries endorsed the privileging of ASEAN investors over foreign investors in the AIA programme, intending the investment preferences to stimulate the growth through regional expansion of domestic firms into larger and more capable enterprises able to compete effectively with TNCs, including through forming ASEAN multinationals. All the core ASEAN governments were broadly united on the importance of domestic firms becoming large and/or multinational as a means for them to survive global market competition. Chapter 4 discussed these points in detail. Whether the idea was a workable one is a separate issue, and beyond the focus of the dissertation.

The point to be stressed is that different forms of regionalism emerged out of the forces of globalisation due to the mediation of domestic political economy dynamics in the core member countries that centred on the growth-distribution tension. Both open regionalism and developmental regionalism were driven by the growth imperative, and were about engaging with globalisation. Nevertheless, proponents of developmental regionalism did not fully accept the hegemonic position of foreign/global firms associated with globalisation, and attempted to nurture domestic firms and capabilities in an environment that was considered to be harshly competitive to developing country capital. The growth imperative was infused with a need to accommodate to domestic distribution priorities centred on elements of domestic capital that were considered to be politically important to ruling elites.

The tension between growth and distribution at the domestic level, which was especially evident in Malaysia and Indonesia, led unsurprisingly to these two countries being involved in major disputes in AFTA over implementation. Although these governments had committed themselves to all three component programmes in AFTA, the reality of the domestic political economy meant that the imperative of distribution overcame the concern with growth on a number of occasions that led to departures during implementation from the CEPT, AFAS, and the AIA. Chapter 5 elaborated on this point. Notwithstanding an excellent track record in the CEPT, Malaysia chose in 1999 to delay liberalising tariffs on automobiles and was also responsible for some of the delays in negotiating liberalisation in the financial services and telecommunications sectors. Indonesia was involved in two major disputes in AFTA over agriculture and petrochemicals. This chapter thus demonstrated that the domestic level was a significant level of analysis, and not merely a transmission belt for structural forces. It was the interaction between the systemic and the domestic that was, and remains, key in explaining developments in AFTA.

The tussle between growth and domestic distributive concerns within member countries, which consequently led to tensions and disputes between them, meant that implementation became a political process that attempted to balance both growth and distributive concerns among members, rather than merely a technical one of complying with commitments already made. The study revealed in Chapter 6 that this was accomplished through bargaining processes that took place to address non-compliance during AFTA implementation. Two outcomes resulted. First, bargaining generally led to a re-negotiation of the original commitment and the adoption of revised, lower targets. This took care of domestic concerns with distribution in affected member countries. By consequently preventing the collapse of the entire project, it also took care of the growth concerns of other members for whom AFTA was important in sustaining the conditions for growth. Second, partial institution building occurred, largely through the tightening of rules and procedures in AFTA, which raised the costs to members of reneging on their original and re-negotiated AFTA obligations while also signalling to business actors, notably foreign investors, that AFTA remained a credible project despite the re-negotiations and setbacks. Institution building, therefore, also addressed the growth imperative.

<u>The IPE framework of analysis and the globalisation-regionalism relationship</u>

The story of AFTA presented in the dissertation, and summarised above, was guided by the theoretical approach adopted. The study was broadly located within an IPE framework of analysis, which consequently emphasised the following elements: the close interrelationship between states and markets, or between politics and economics; the integration of the domestic and international levels of analysis; and the central role of capital in the contemporary world economy. Domestic capital in particular was a crucial analytical variable. It is the contention of the study that the neglect of one or all of these considerations has been responsible for many of the shortcomings of the literature on AFTA to date.

As a consequence, it was felt necessary to locate the study of AFTA within the IPE literature on the globalisation-regionalism relationship. The dominant model of this relationship, the model of open regionalism, is also regarded as a project of neoliberal regionalism underpinned by neoliberal ideas and practices. It is a model that is underwritten by a liberal political economy perspective and neoclassical ideas about economic efficiency and the benefits of engaging with market competition. Much of the current interpretation of AFTA in the literature implicitly follows this line of theoretical argument, viewing AFTA as a project of open regionalism designed to engage with the global market. The present study does not challenge the broad notion of AFTA as a project of open regionalism. Nevertheless, by adopting a modified economic realist theoretical perspective combined with the elite governance model of domestic politics, the study offers a more nuanced reading of open regionalism in AFTA as well as advances the argument that AFTA also displayed the features of developmental regionalism.

In theoretical terms, the economic realist perspective offered substantial analytical purchase over liberal and structuralist perspectives in explaining regionalism as a response to globalisation, though it needed to be combined with a suitable model of domestic politics for richer insights. Chapter 1 elaborated on these points. The value of economic realism as a theoretical tool comes from its recognition that states continue to matter, and more importantly, that the governments of these states can, and often do consciously manipulate inter-state relations to try and alter international political economy structures in line with domestic interests. Regionalism can be interpreted as one such instrument for states to pool their resources in order to influence the international political economy. The dominant liberal model of open regionalism in the literature takes global market outcomes as a given and beneficial to all, with regionalism merely a means to subordinate national economies to these beneficial forces of globalisation. In the liberal reading of regionalism, therefore, regionalism involves very little purposive political action by governments of states to alter global market outcomes.

The domestic level was a necessary level of analysis, because it was at this level that globalisation was mediated by the growth-distribution dynamic of elite governance political systems, which, in turn, shaped individual country preferences towards regionalism. The conventional realist practice of deriving the preferences of state actors solely from the systemic level, notably from the dynamics of inter-state power political competition, was therefore rejected. The dominant liberal model of open regionalism in the literature similarly derives the motivation for regionalism from the systemic level, from global market pressures on firms and the economy. The traditional approach to European integration – neofunctionalism – suffers from a similar neglect of the domestic level (Moravcsik, 1993: 477). An attempt by Moravcsik to overcome this weakness by developing a combined international-domestic model of European integration (the liberal intergovernmental model) was, however, criticised for similarly assigning a determining role to structure despite explicitly modelling the domestic level as a source of national preference formation (Gofas, 2001: 4-5). In his model, Moravcsik, (1993: 495) derives the interests of domestic social groups in relation to their international competitiveness, with governments then implementing their wishes in a pluralist model of domestic politics. Domestic politics, thus, merely acts as a transmission belt for structurally derived interests with regard to European integration (Rathbun, 1999: 4, fn3).

Unlike Moravcsik, this dissertation attempts to derive the preferences of ASEAN member governments with regard to AFTA agenda items from domestic political priorities shaped by domestic state-society relations centred on the imperatives of growth and/or distribution. Both these imperatives are ultimately linked to political concerns centred on the legitimacy and security of governing regimes in ASEAN. These domestic priorities shape the way external events and developments are interpreted by domestic actors as well as influence government responses to these external forces, which in turn serve as a set of constraints and opportunities for the attainment of these domestic priorities. The discussion in the introductory chapter, in fact, pointed out that the realist tradition does accord analytical priority to the domestic level, unlike its neorealist counterpart.

The integration of the domestic level in the dissertation also allowed the analysis to explicitly consider domestic capital as a key analytical variable, and importantly, allowed business actors to be identified as part of domestic society rather than simply as atomistic profit-maximising agents with no social identity. The dominant liberal model does not make an adequate distinction between foreign and domestic capital, focusing instead on globally oriented business whose competitive position regionalism helps advance. If a distinction is made at all, it is usually to view domestic business as agents of protectionism likely to resist regional liberalisation. Chapter 1 also suggested that this was because of the model's focus on the industrial world where domestic capital is likely to be well developed, unlike in the developing world. In settings where domestic capital is not as well developed as foreign capital but plays crucial political roles, governments may well respond to globalisation in ways that attempt to preserve and nurture domestic capital in anticipation of eventual global competition.

The theoretical literature on the globalisation-regionalism relationship identified a dominant model of open/neoliberal regionalism as already noted, and a second model of regionalism based on resistance by domestic social groups to globalisation. The latter was a useful corrective to the highly economistic open/neoliberal model of regionalism in the literature. Nevertheless, the discussion in Chapter 1 criticised the second model for integrating the domestic level only in superficial fashion, and repeating many of the shortcomings of the dominant neoliberal model, notably the separation of economics and politics. The weaknesses of the main models of the globalisation-regionalism relationship in the literature were overcome in the present study by the adoption of a modified economic realist framework.

The combined economic realist-domestic politics framework allowed a third theoretical model – developmental regionalism – to be advanced, which also drew insights from strategic trade theory in economics rather than liberal/neoclassical economics. Developmental regionalism, like open regionalism, is premised on engagement with globalisation in the long-term but offers domestic firms some form of temporary shelter from global competition or some advantage to meet competition in the medium-term. It is, therefore, not a model of resistance to globalisation, but neither is it a model of complete acquiescence to global market forces. Economic realist insights, moreover, allowed a subtle distinction to be made within the dominant open regionalist model to reveal two variants, neoliberal regionalism and the FDI model of regionalism, the latter more likely to reflect embedded or limited neoliberalism encompassing elements of state intervention in markets. The distinction between the two variants is not a trivial one. The discussion in Chapter 1 suggested that the two variants of open regionalism were likely to display distinct features and crucially for this discussion, to project different future trajectories for regionalism.

The theoretical framework adopted in the study also helped to address the divide between structure and agency, a key conceptual issue in IPE. The combined economic realist-domestic politics analytical framework allowed for the possibility of agency on the part of key actors in two possible ways. First, domestic actors, principally but not exclusively governments, interpreted and responded to specific aspects of globalisation in ways that were shaped by domestic social and political settings. In short, globalisation did not manifest itself as an objective structure. Second, governments displayed agency to the extent that they attempted to alter the structures and processes of the global economy through inter-state cooperation in fulfilment of the common interests of the state or political community.

Governments were driven to this action by the essentially zero-sum nature of global market forces presumed in the economic realist perspective on IPE, where benefits for some are at the expense of others. This dynamic was revealed in the discussion in Chapter 3 on the concern in ASEAN with FDI diversion to other countries, notably China. It was also implicit in the notion of developmental regionalism discussed in Chapter 4, in which its proponents aimed at nurturing domestic capital through according them temporary advantages over foreign capital in the regional market in anticipation of global market competition. It is clear that there is a strong redistributive element associated with AFTA, both in terms of re-directing FDI to the region and in conferring privileges, albeit on a temporary basis, to domestic/ASEAN capital over foreign capital.

Both these arguments share the fundamental notion that ASEAN leaders and policymakers did not accept the prevailing structures of globalisation and attempted to use regionalism to alter the outcomes of global market forces. This was evident in both open regionalism and in developmental regionalism. Open regionalism, initiated as a means to redirect globally mobile FDI to the ASEAN region, may be considered to be an activist response by national governments seeking to influence the workings of global market forces, this time in the way FDI was allocated worldwide. Available studies of AFTA do not emphasise this particular point, although they do recognise it as a project of open regionalism designed to remain engaged with global markets. As already noted, theirs is an implicit liberal interpretation of AFTA. Although their argument that AFTA was specifically about countering the FDI threat from China is correct, it cannot be fully accommodated within liberal perspectives that see global market forces in essentially beneficial and non-zero-sum terms. This reflects the lack of explicit attention to theorising in these generally atheoretical studies of AFTA, a point that was noted in the introductory chapter.

AFTA and the future of wider regionalism

An economic realist reading of AFTA, specifically the FDI model of regionalism suggests that ASEAN member governments would be cautious about any development that threatened to blunt the contours of the ASEAN region as a distinct functional space of investment/production. This implies that the prospects for ever-widening processes of regionalism from the original regionalist project would be far more limited than liberal readings would suggest. The cautious response of all the ASEAN leaders and policymakers to China's proposal to form a free trade area between China and ASEAN is, therefore, completely understandable from the economic realist point of view.[1] China would by itself offer foreign capital a 'regional' site of production by virtue of its size and internal industrial complementarities, which could prompt foreign investors to establish

[1] These responses are detailed in *Business Times (Singapore)*, 'All eyes on China push for FTA', 24 November 2000.

production networks within the Chinese territory with little production linkages with ASEAN, instead trading the output produced to ASEAN. This would defeat the purpose of the regionalist exercise for the latter, which is to stimulate investment to the region and the establishment of regional production networks involving their respective economies.

Most analysts have referred to the internal problems in AFTA over implementation as the major stumbling block to a wider free trade zone.[2] This study suggests that the region's competitive dynamic with China over FDI is likely to prove the bigger obstacle. The ASEAN countries side-stepped the issue of a free trade zone with China by agreeing to a one-year feasibility study on the proposal.[3] Although this is not to suggest that a wider free trade zone with China will never materialise in the future, the argument put forward is that the ASEAN governments will probably delay the process for so long as they regard China as a major competitor for FDI. ASEAN member governments may not concur with liberal expectations that wider regionalism, particularly with China, would necessarily be a good thing on economic grounds.

It is perhaps for similar reasons that APEC seems to have lost whatever attractions it may have once had for those ASEAN governments initially supportive of the idea of Asia-Pacific regionalism. Not only has AFTA advanced further than APEC, particularly in the CEPT, notwithstanding a few setbacks, APEC would subsume ASEAN and blur its distinction as a regional production space. As noted in Chapter 1, while globalisation involves agglomeration tendencies that emphasise a regional division of labour rather than a global one, it is still unclear what the 'ideal' contours of such a regional space are. Under

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[2] *Financial Times*, 'Governments ponder Asian trade zone' 25 November 2000.
[3] *Ibid.*

such uncertainties, ASEAN/AFTA as a production region may well be obliterated within APEC if producers preferred the APEC regional space over the ASEAN/AFTA space.

AFTA and regionalisation dynamics in Southeast Asia and the wider Asia-Pacific

Despite setbacks in AFTA, the project appears to have the potential to alter the dynamics of regionalisation in Southeast Asia and the wider Asia-Pacific region. Although intra-ASEAN trade levels remained modest during the 1990s, averaging around 20-25 per cent of total trade, this is not the main criterion with which to judge AFTA, since the regionalist project was primarily designed to boost FDI to the region. Investment flows to the region were fairly stable during the 1990s, at least until 1997 and despite the growing competition posed by China. Investment inflows averaged about 20 per cent of global FDI flows to developing countries and about 30 per cent of global FDI flows to Asian developing countries until the financial crisis (ASEAN Secretariat, 1999a: 131). Moreover, intra-ASEAN investment flows strengthened significantly during the 1990s, particularly flows from the core members to the newer members (ASEAN Secretariat, 1999a: 13). Macro data on investment flows is, however, limited because it does not reveal whether the flows were influenced by the AFTA project. Neither does macro data indicate the prospects for an ASEAN regional division of labour through regionalised production operations.

Surveys of business decisions and of pronouncements by corporate leaders were more revealing. A survey of 150 firms in the East Asian region conducted for the Economist Intelligence Unit in late 1996 revealed that these firms regarded AFTA as the regional project most likely to be realised or implemented compared to APEC. More significantly, a third of those surveyed admitted that AFTA had a major impact on their business operations, while 41 per cent believed the impact was moderate. Only 6 per cent admitted that AFTA made no difference to their business operations. Moreover, almost 62 per cent of corporate leaders surveyed acknowledged that they had incorporated AFTA as a factor in their future regional production strategies.[4] A survey conducted among Asian regional business executives by the *Far Eastern Economic Review* revealed essentially similar results.[5] It revealed that more than three quarters of Asian executives surveyed made investment decisions that took the AFTA regional market into account. Studies by Japan's Export-Import (EXIM) Bank, the Japan External Trade Organisation (JETRO), and the Nomura Research Institute also revealed that an increasing number of Japanese firms were stepping up regional operations in view of the AFTA market, especially in the automobiles, automotive components, and electrical and electronic sectors.[6]

These surveys suggest that business leaders regarded AFTA as a viable regional project that influenced their production and investment decisions. A wide range of TNCs and other Southeast Asian firms, in sectors like food and beverages, cosmetics, petrochemicals, automotive components, automobiles, electrical items, textiles and apparel developed regional production and investment strategies based on calculations involving AFTA. Major TNCs involved included Ciba-Geigy, Nestle, Electrolux, General Electric, Dow Chemicals, Goodyear, Philips, Colgate-Palmolive, Unilever, Ford Motors, General Motors, BMW, Volvo, Mercedez Benz, Kia, Hyundai, Matsushita, Sharp, Toshiba, Honda, Toyota, and Nissan, among others.[7] A functioning regional space of production appears to be taking shape in ASEAN through the AFTA project.

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[4] The survey results were reported in Baldwin (1997: 126).
[5] *FEER*, 7 August 1997, p. 39.
[6] Reported in ASEAN Secretariat (1999a: 16).
[7] From various issues of *The Nation, Bangkok Post, Business Times (Singapore), Business Times, and New Straits Times (Malaysia).*

Promising lines of further enquiry

Two further lines of research that emerge from the present study of AFTA should be identified in this conclusion. The first stems from the suggestion in the dissertation that the prospects for wider regionalism, particularly a formal free trade zone with China, is rather limited. Despite the cautious approach of the ASEAN governments to China's proposal, other regional projects involving the ASEAN countries and the Northeast Asian economies including China have been adopted, particularly since the financial crisis. One of these projects is the 'ASEAN Plus Three' forum, which focuses on cooperation on monetary and financial issues among ASEAN and the countries of Northeast Asia, leading some scholars to suggest that this represents the beginnings of East Asian monetary regionalism (Dieter, 2000). The point here is that other dynamics are intruding into the region, apart from the competitive dynamics associated with FDI. These make cooperation with China more attractive. The issue of how the interaction of competitive and cooperative dynamics between ASEAN and China shapes regionalism promises to be not only an attractive line of further research but also a major policy issue in coming years.

The second possibility for further research stems from the point emphasised in this concluding chapter that AFTA may be in the process of altering ASEAN's regional dynamics through influencing corporate investment and production decisions. There are broader political implications of the growing interest in the ASEAN/AFTA region currently shown by TNCs from the US and Europe. The most important of these is whether these emergent trends will challenge the dominant position of Japanese firms in ASEAN even as the latter similarly step up investment in the ASEAN region. If developmental regionalism bears fruit, it too could weaken the relative position of Japanese firms in the regional economy. The ASEAN region has traditionally been viewed as part of a Japanese regional division of labour, that in turn, underpins Japan's influence in the region and its imputed role as regional leader (Hook, 1996). Mittelman, for instance, sees the ASEAN countries as "highly enmeshed in the Japanese vector of the globalisation process" and consequently to be subject to a Japanese regional hegemony (Mittelman, 2000: 126-7). Further research is needed that explores how investment and production structures in the region may be changing due to AFTA, and the implications of such material economic changes for the distribution of regional political power. Both lines of research identified above have wider implications for the international politics of East Asia.

APPENDIX

LIST OF INTERVIEWEES

A. ASEAN Secretariat, Jakarta, Indonesia

1. Mr Rodolfo Severino, Jr.
   Secretary General of ASEAN

2. Dr Suthad Sethboonsang
   Deputy Secretary General of ASEAN

3. Dr Robert Teh, Jr
   Director , Bureau of Trade, Industry and Services

4. Mr Lim Hong Hin
   Assistant Director , Bureau of Trade, Industry and Services

5. Dr Wee Kee Hwee
   Assistant Director , Bureau of Investment, Finance and Surveillance

6. Dr Aladdin D. Rillo
   Senior Officer , Bureau of Investment, Finance and Surveillance

B. Indonesia

7. Mr Ketut Suarka
   AFTA Division, Ministry of Industry and Trade, Jakarta

8. Mr Sutriono Edi
   AFTA Division, Ministry of Industry and Trade, Jakarta

9. Mr Ramelan
   Services, Investment and AICO Division, Ministry of Industry and Trade, Jakarta

10. Dr Hadi Soesastro
    Executive Director, Centre for Strategic and International Studies (CSIS), Jakarta

11. Dr Tubagus Feridhanusetyawan
    Senior Economist, Centre for Strategic and International Studies (CSIS), Jakarta

12. Dr Haryo Aswicahyono
    Economist, Centre for Strategic and International Studies (CSIS), Jakarta

C. Singapore

13. Mr Ridzwan bin Haji Dzaffir
    High Commissioner to Bangladesh, Ministry of Foreign Affairs, Singapore
    (until 1998, Director-General of ASEAN Economic Cooperation, Singapore Trade Development Board)

14. Mr Kong Mun Pew
    Director, International Operations (Southeast Asia), Singapore Trade Development Board

15. Ms Lim Bee Suan
    Trade Officer, International Operations (Southeast Asia), Singapore Trade Development Board

16. Dr Henry Wai-Cheung Yeung
    Assistant Professor in Economic Geography, Department of Geography, National University of Singapore

17. Dr Leonard Sebastian
    Fellow, Regional Strategic Studies Programme, Institute of Southeast Asian Studies (ISEAS), Singapore

D. Malaysia

18. Mr Razak Ramli
    Deputy Secretary General, Ministry of International Trade and Industry, Kuala Lumpur

19. Mr Paramjit Singh Tyndall
    Research Fellow, Malaysian Institute of Economic Research (MIER), Kuala Lumpur

20. Dr Leong Choon Heng
    Director of Research, Malaysian University of Science and Technology, Kuala Lumpur

21. Mr Ong Hong Cheong
    Retired Senior Analyst, Institute of Strategic and International Studies (ISIS) Malaysia [e-mail interview]

22. Anonymous

E. Thailand

23. Mr Karun Kittisataporn
    Director-General, Department of Business Economics, Ministry of Commerce, Bangkok

24. Ms Chularat Suteethorn
    Director, International Economic Policy Division, Ministry of Finance, Bangkok

25. Mr Lavaron Sangsnit
    Chief, AFTA Unit, Ministry of Finance, Bangkok

26. Mr Manasvi Srisodapol
    Counsellor, Department of ASEAN Affairs (Division of Commerce and Industry),
    Ministry of Foreign Affairs, Bangkok

27. Mr Siriruj Chulakaratana
    Plan and Policy Analyst, Office of Industrial Economics, Ministry of Industry, Bangkok

28. Ms Doojduan Sasanavin
    Senior Plan and Policy Analyst, Office of Agricultural Standards and Inspection
    Ministry of Agriculture and Cooperatives, Bangkok

29. Dr Nipon Puapongsakorn
    Consultant, Thailand Development Research Institute (TDRI), Bangkok

All interviews were conducted between July and September 2000, with the exception of the e-mail interview with Mr Ong Hong Cheong of Malaysia, which was conducted in May 2001.

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