THE FALSE PROMISES OF AN ASEAN-EU FTA

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1. The case for an ASEAN-EU FTA is made in three documents that have not been widely circulated nor have been made the object of public debate. A careful examination of their contents reveals that the promises of gains associated with an ASEAN-EU FTA are false promises.

I. The EU's Press Release of 23 April 2007

2. The European Commission claimed that according to independent research an ASEAN-EU FTA would boost EU exports to ASEAN by 24.2%; the latter would see an increase of 18.5% of its exports to the EU. The biggest gains for both the EU and ASEAN would lie in the area of business services (a 29% increase worth 7.9 billion euros for the EU, and an 80% increase for ASEAN worth 14 billion euros).[2]

3. Since the European Commission is a staunch advocate of the proposed FTA, it could hardly be expected to announce anything other than favorable estimates. However, the European Commission's record in assessing the impact of FTAs is hardly trustworthy.

4. When the EU-Mexico FTA entered into force in 2000, the Delegation of the Commission in Mexico predicted that Mexican exports to the EU would rise from $4.801 billion in 1999 to $30.002 billion in 2005. In reality, in the first two years of the agreement the growth of Mexican exports was negative. Subsequently, Mexican exports did increase, but in 2006, they amounted to only $10,890,288,000, a far cry from the $30 billion predicted by the EU for 2005. Worse, Mexican imports from the EU grew even more rapidly, reaching $27,847,488,000 in 2006. The predictable result was a steadily growing trade deficit, from $9.4 billion in 2000 to $14,202,537,000 in 2004 and $16,957,200,000 in 2006. Between 2000 and 2006, Mexico's deficit with the EU increased 79.6%.[3]

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[2] European Commission, "European Commission Welcomes Adoption of Negotiating Mandates for new Free Trade Agreements with India, Korea and ASEAN." Brussels, 23 April. Available in http://www.bilaterals.org/article-print.php3?id_article=7979 (accessed 24 April 2007).

[3] Carlos A. Rozo, "El TLCUEM [Tratado de libre comercio Unión europea - México]: evaluación de resultados económicos," Universidad Autónoma Metropolitana, Unidad Xochimilco. Departamento de producción económica. Documento de trabajo, 2004, pp. 5, 26; Rafael Velázquez Flores and Roberto Domínguez Rivera, 2004. "Relaciones México-Unión europea: una evaluación 2000-2004" presented at the Dialogue Forum between civil societies and the institutions of the Mexican Government and of the European Union, 28 February-1 March

5. In the light of the European Commission's past errors, we can legitimately ask the following questions:

- What reason is there to believe that the European Commission's present favorable estimates are any more reliable than those that it has made of gains from other EU FTAs with developing countries?
- Who is to be accountable if the estimates prove to be erroneous?
- Who is to compensate the ASEAN country that experiences steadily rising trade deficits vis-à-vis the EU?
- Is the FTA to be suspended or annulled if the ASEAN country/countries' trade balances fail to improve?

II. The Economic Impact of a Potential FTA between the EU and ASEAN (The Quantitative Impact Study)(2006)

6. The Quantitative Impact Study[4] concluded that the gains of an FTA are very large, amounting to more than 2% of GDP in 2020, although the gains for the least developed member states (Cambodia, Laos, Myanmar and Vietnam) would be more modest.

7. The study examined the potential effects of an FTA according to four scenarios:

<u>Scenario 1</u> - full liberalization in goods, reduction of protection in services by 50%
<u>Scenario 2</u> - limited liberalization in goods (i.e., sensitive products are excluded from liberalisation), reduction of protection in services by 50%
<u>Scenario 3</u> - scenario 1 + conclusion of FTAs between ASEAN and other industrialized countries, and between the EU and Mercosur
<u>Scenario 4</u> - full liberalization in goods, no reduction of protection in services.

8. In practically all scenarios, production in ASEAN will decline by 2020 primarily in the manufacturing sectors.

<u>Scenario 1</u>: wood products (I, M, P, S, V); Cars and trucks (I, M, P, S, V); Other transport equipment (I, M, S,); Metal and mineral products (I, M, S, V); paper (I, M, S); Electronic equipment (I, M, S, V); Machinery and equipment (I, M, S, V); other manufactures (I, M, S, V).[5]

2005, Mexico; Rodolfo Aguirre Reveles, and Manuel Pérez Rocha L., "El TLCUEM [Tratado de libre comercio Unión europea - México] a 7 años: un caso más de 'espejitos de oro'," RMALC (Red Mexicana de Acción Frente al Libre Comercio), 8 August 2007.. Available at http://www.bilaterals.org/article-print.php3?id_article=7409 (accessed 13 April 2007).

[4] CEPII-CIREM, "Economic Impact of a Potential Free Trade agreement between the European Union and ASEAN. Final Report 2006-05-03." 2006. Trade Specific Contract No.S12.424.310 implementing Framework Contract No. Trade/05/HE/01/1c. Commission of the European Union. Directorate General for Trade.

[5] *Ibid.*, pp. 26-27.

Scenario 2: apparel (M, rest of ASEAN); textiles (M); leather (I, M, P, S); Cars and trucks (I, M, P, S); other transport equipment (I, M, rest of ASEAN, S); metal products (I, M, rest of ASEAN, s); electronic equipment (I, M, rest of ASEAN, S); machinery and equipment (I, M, rest of ASEAN, S); other manufactures (I, M, rest of ASEAN, S).[6]

Scenario 3: apparel (M, rest of ASEAN), textiles (M); leather (I, M, P, S); cars and trucks (I, M, P, S); other transport equipment (I, M, rest of ASEAN); metal and mineral products (I, M, S, V); electronic equipment (I, M, rest of ASEAN, S, V); machinery and equipment (I, M, rest of ASEAN, S, V).[7]

Scenario 4: cars and trucks (I, M, P, S, V); other transport equipment (I, M, rest of ASEAN, S); metal and mineral products (I, M, P, S, V); electronic equipment (I, M, P, S, V); machinery and equipment (I, M, P, rest of ASEAN, S, V); other manufactures (I, M, rest of ASEAN, S, V).[8]

9. Conversely, production in ASEAN will increase mainly in agriculture and fishing :

Scenario 1: fishing (I, M, P, rest of ASEAN, S, T); rice (all ASEAN members); sugar (all ASEAN members); animals and other meat (I, M, rest of ASEAN, S, T); vegetable fats and oils (P, rest of ASEAN, T); beverages, tobacco and dairy (I, M, P, T, V); food products (all ASEAN members except V).[9]

Scenario 2: fishing (all ASEAN members except V); rice (all ASEAN members); sugar (all ASEAN members except S and V); animals and other meat (all ASEAN members); vegetable oils and fats (P, rest of ASEAN, T); beverages, tobacco and dairy (all ASEAN members except V); food products (all ASEAN members except M and V).[10]

Scenario 3: fishing (all ASEAN members except V); rice (all ASEAN members); sugar (all ASEAN members except V); animals and other meat (all ASEAN members except S and V); vegetable oils and fats (I, P, rest of ASEAN, T); beverages, tobacco and dairy (all ASEAN members, except rest of ASEAN); food products (all ASEAN members, except V).[11]

Scenario 4: fishing (P, S, V); rice (all ASEAN members); sugar (all ASEAN members except S); animals and other meat (M, rest of ASEAN, S, T); vegetable fats and oils (P, rest of ASEAN, S); beverages, tobacco and dairy (M, rest of ASEAN); food products (M, rest of ASEAN, S).[12]

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[6] *Ibid.*, pp. 30-31.
[7] *Ibid.*, pp. 34-35.
[8] *Ibid.*, pp. 26-27.
[9] *Ibid.*.
[10] *Ibid.*, p. 30.
[11] *Ibid.*, p. 34.
[12] *Ibid.*, p. 26.

10. The picture emerging from the study is one in which ASEAN countries increasingly specialize in primary products and steadily withdraw from industrial production.

11. Not surprisingly, the study concluded that the bulk of the gains under an ASEAN-EU FTA, estimated at three-fourths of ASEAN gains, are associated with the liberalization of services. The study also argued that demand for skilled and unskilled labor would increase in the business services sector (by 85% and 101%).[13] Unfortunately, it was not clarified whether all those who lose their jobs in industrial production will find jobs in the services sector or whether some will be forced by one means or another to take up fishing, farming and poultry and livestock raising.

12. One major shortcoming of the quantitative study lies in its failure to estimate the loss of tariff revenues associated with the establishment of an FTA.

13. In contrast, impact studies of future EU FTAs in other regions have been able to estimate the loss of tariff revenues for the developing countries concerned. Thus, the UN Economic Commission for Africa has calculated that in Southern Africa, Angola would lose $103.2 million, Tanzania $32.5 million and Mozambique (the smallest economy in the region), $7.6 million following the implementation of an FTA with the EU.[14] In the case of Mexico, it has been estimated that the loss of revenues attributable to the implementation of the EU-Mexico FTA amounts to $300 million per year.[15]

14. In Chile, to compensate for the loss of tariff revenues attributable to the very large number of FTAs that the country has signed, the government was forced to raise the VAT from 18 to 19%.[16]

15. In the light of these data, we must ask whether:

- the ASEAN countries are willing to withdraw from industrial production;
- they are in a position to provide jobs in agriculture and services to those who lose their jobs in industrial production;
- they are ready to face the loss of tariff revenues associated with the establishment of an FTA.

[13] *Ibid.*, p. 27.

[14] Stephen Karingi, Rémi Lang, Nassim Oulmane, Romain Perez, Mustapha Sadni Jallab and Hakim Ben Hammouda, *Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements* (Addis Ababa: UN Economic Commission for Africa, 2005), p. 80.

[15] Jorge A. Calderón Salazar, "La experiencia del Tratado de libre comercio Unión europea – México," presented at the Facultad de Economía de la Universidad Nacional Autónoma de México, 24 August 2005. Available at http://www.prd.org.x/ierd/coy13/jcs.htm (accessed 13 April 2007).

[16] Alvaro Ramis, "Desigualdades del 'libre comercio'," *Punto final,* 615, 13 May 2006. Available in http://www.puntofinal.cl/619/desigualdades.htm (accessed 13 April 2007)

III. A Qualitative Analysis of a Potential FTA between the EU and ASEAN (The Qualitative Impact Study)(2006)

16. The Qualitative Impact Study claimed that "the case for an FTA appears to be quite compelling, for exclusively economic reasons."[17]

17. European respondents to a survey conducted by the Study's authors sought the reduction of tariffs mainly in medium and high-value sectors in manufacturing, such as chemical products and in the automobile industry.[18]

18. The Study criticizes conditions that ASEAN countries have imposed on foreign manufacturing firms if they are to be allowed to produce in the host countries or to benefit from incentives granted by the latter. An example of such a requirement is local content, which imposes the use of a certain amount of local inputs in production.

19. Local content requirements are justified by the need to establish linkages between supplier firms and manufacturing firms. They facilitate job creation and make possible the diffusion of technology. Abolition of local content requirements would deprive governments of one means of encouraging industrial production.

20. The Study also criticizes the gap between bound and applied tariffs for many products in the ASEAN countries, on the grounds that they add "considerable uncertainty" for exporters to Southeast Asia.[19] Bound tariffs constitute the upper limit above which WTO members commit themselves not to raise tariffs. Applied tariffs are those that are actually collected by the government. The difference between bound and applied tariffs gives the country concerned some room for maneuver, leaving it the possibility of raising its tariffs above the actually applied rate and up to the bound level without breaching its WTO obligations. The flexibility offered by high bound tariffs enables the country to support domestic industry.

21. The Study also criticizes exemptions from duties that ASEAN countries grant for inputs into local production, under certain conditions. For example, Malaysia grants exemptions from import duties for raw materials and components used in the manufacture of goods for export and for machinery and equipment that are not available in Malaysia but are used directly in the manufacturing process. In the Philippines, firms earning at least 50% of their revenue from exports are eligible for tax credit for taxes and duties paid on imported raw materials used in the processing of export products. Firms that export at least 70% of their output are eligible for exemption from taxes and duties on imported spare parts. Thailand and Vietnam have similar

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[17] Asia-Europe Centre (University of Limerick) and Institut Français des Relations Internationales, "A Qualitative Analysis of a Potential Free Trade Agreement between the EU and ASEAN. A Report prepared for the European Commission and the EU-ASEAN Vision Group," 2006. Contract Number SI2.421512.

[18] *Ibid.*, p. 169.

[19] AEC-IFRI, 2006, p. 32.

schemes.[20]

22. If these duty exemptions are abolished, the result might well be to discourage manufacturing in ASEAN countries. This negative consequence would not be compensated for by European investment in manufacturing, since European firms are interested primarily in investing in services.

23. Liberalization of "trade in services" requires the elimination of restrictions on FDI. By their nature, services cannot be traded, so that trade in services relies mainly on FDI. From the European point of view, the barriers to market access come in the form of restrictions on FDI, such as limits on foreign equity share (foreign equity in infrastructure, including telecommunications, is limited to 40% in the Philippines; foreign equity in banks is limited to 25% in Thailand; 100% foreign equity is not permitted in air, rail and sea transport in Vietnam); restrictions on the type of commercial establishment allowed (branches, subsidiaries or joint ventures; foreign branches of insurance companies are not allowed in Indonesia; foreign retail banks are not allowed to establish new branches in Malaysia); the scope of service (fixed telephone lines are owned by Telekom Malaysia); and the employment of foreign personnel .[21]

24. The Qualitative Impact Study asserted that in ASEAN, such restrictions maintained profits for local companies and preserved local employment, at the cost of the inefficiency and non competitiveness of the service sectors.

25. Very little effort is made in the Impact Study to justify the underlying assumption that liberalization of trade in services is beneficial to ASEAN countries, particularly in stimulating production. Since services are not tradable, the contribution of FDI in services to increasing ASEAN-EU trade is at best indirect: better telecommunications and transport services are said to be necessary if trade in goods is to expand.[22]

26. Of course, should the Quantitative Study's forecast of a decline in production of manufactured goods in ASEAN turn out to be accurate, an increasing part of ASEAN goods needing transport to Europe will be agricultural products.

27. A scenario of declining industrial production will prompt other questions as to the contribution of European FDI in services to economic growth. One might ask, for example, to whom European banks and insurance companies will provide financing if local manufacturing firms are not expanding production and European firms are not investing in industry. The temptation might be greater for the European banks and financial institutions to provide consumer credit, and in the case of the Philippines and Indonesia, to take a larger share of the business of remittances from overseas workers.[23]

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[20]AEI-IFRI, 2006, p. 34.
[21]*Ibid.*, pp. 42-52.
[22]*Ibid.*, p. 133.
[23]European banks in Mexico are said to target remittances from Mexican workers in the US in

28. Should ASEAN countries be comforted by the prediction that under Scenario 1, the business Services sector's demand for skilled labor will increase by 85% and for unskilled labor by 101%? the problem is that it is not certain that these percentages refer to 85% of the skilled workers and 101% of the unskilled workers who will lose their jobs in manufacturing.

29. Supposing that a few years after the entry into force of an FTA, ASEAN members discover that the decline in manufacturing is not sufficiently compensated for by increased activity in agriculture and in the service sector and that they wish to arrest or reverse the industrial decline. Or perhaps they might wish to develop comparative advantage in emerging industrial sectors. With an FTA in place, they would no longer be in a position to implement an industrial policy, as the FTA would have obliged them to renounce the use of many of their regulatory instruments.

30. It could be argued that since the Asian financial crisis, ASEAN countries have already done this unilaterally. Yet there is still a difference between the present situation and an FTA scenario. At present, ASEAN members retain a degree of flexibility, allowing them to modify or adjust their use of these policy instruments in response to changing circumstances. Under an FTA, such flexibility would disappear for good.

31. Having these considerations in mind, ASEAN countries should ask themselves whether:

- they are willing to remove incentives for local manufacturing production;
- they wish to increase European FDI in services sectors whose contribution to increasing trade with the EU is doubtful;
- they wish to renounce the instruments of industrial policy forever, thus giving up the possibility of arresting a decline in manufacturing or of developing specialization in new industrial sectors.

IV. Conclusion

32. The future of ASEAN emerging from the scenarios described in the Impact Studies is one in which they progressively withdraw from industrial production and return to traditional specialization in agriculture. Other developing countries that have not been as successful as ASEAN in increasing their industrial production criticize FTAs with the EU for preventing them from diversifying their economic structures, which still rely heavily on the production of primary commodities. If ASEAN countries enter into an FTA with the EU, they will find themselves in the paradoxical situation of reversing their success in expanding the share of manufacturing in their economies.

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their future activities. Alfonso Moro, *Los intereses de las transnacionales europeas en America latina* (Paris:Red Mexicana de Acción Frente al Libre Comercio (RMALC), April 2004), p. 15.