Hopes and Fears:
Indonesia's prospects in an ASEAN–EU Free Trade Agreement

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The Trade Knowledge Network is a global collaboration of research institutions across Africa, Asia, Europe and the Americas working on issues of trade and sustainable development. Coordinated by the International Institute for Sustainable Development (IISD), the TKN links network members, strengthens capacity and generates new research to assess and address the impact of trade and investment policies on sustainable development.

The overarching aim of the TKN is to help ensure that trade and investment contribute to sustainable development, with social development and the environment equitably addressed in trade and investment policies. The TKN furthers this aim by generating compelling research with clear policy recommendations and communicating those effectively to decision-makers nationally, regionally and globally.

The TKN is hosted by the International Institute for Sustainable Development, a Canada-based not-for-profit organization promoting change towards sustainable development. As a policy research institute dedicated to the effective communication of its findings, the Institute engages decision-makers in government, business, NGOs and other sectors in the development and implementation of policies that are simultaneously beneficial to the global economy, the global environment and to social well-being.

This study is part of a larger TKN project that seeks to better understand the impacts of investment incentives on sustainable development. Similar country case studies were carried out for the chemical industry in Indonesia (by the Center for Asia Pacific Studies at Gadjah Mada University, Indonesia), the mining industry in Vietnam (by the Central Institute for Economic Management, Vietnam) and the tourism industry in Malawi (by the University of Malawi and the South African Institute of International Affairs). In addition, a regional study examines the effectiveness of investment incentives in attracting FDI and promoting economic growth, social development and environmental protection in Southeast Asia. Finally, a checklist sets out some key issues and questions to be addressed when assessing the sustainable development impacts of investment incentives. The project outputs are available on the TKN website.

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Table of Contents

List of Tables

List of Figures

Abbreviations and Acronyms

ABC	ASEAN Brussels Committee
ACP	Africa, Caribbean, and Pacific
AEC	ASEAN Economic Community
AEM	ASEAN economic ministers
AEMM	ASEAN–EC/EU Ministerial Meeting
AEUFTA	ASEAN–EU Free Trade Agreement
AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area/Agreement
AIA	ASEAN Investment Area/Agreement
AIPO	ASEAN Inter-Parliamentary Organization
APEC	Asia-Pacific Economic Cooperation
API	Aliansi Petani Indonesia (Indonesian Farmers' Alliance)
APRIS	ASEAN Programme for Regional Integration Support
APT	ASEAN plus Three
ARF	ASEAN Regional Forum
Article 133 Cypriot	Cypriot representative on the Article 133 Committee
Article 133 UK	UKrepresentative on the Article 133 Committee
ASEAN	Association of Southeast Asian Nations
ASEF	Asia–Europe Foundation
ASEM	Asia–Europe Meeting
BFTA	bilateral free trade agreement
BKPM	Badan Koordinasi Penanaman Modal (Indonesian Investment Coordinating Board)
BTA	bilateral trade agreement/arrangement
CAP	Common Agricultural Policy
CCP	Common Commercial Policy
CEC	Commission of the European Communities
CEPII	Centre for Future Studies and International Information (Centre d'Etudes Prospectives et d'Informations Internationales)
CGE	computative general equilibrium (model)
CIREM	Centre for Information and Research on the Global Economy (Centre d'Information et de Recherche sur l'Economie Mondiale)
CLMV (countries)	Cambodia, Lao PDR, Myanmar and Vietnam
COREPER	Committee of Permanent Representatives
CPI	consumer price index
CSIS	Centre for Strategic and International Studies
CSO	civil society organization
CSP	Country Strategy Paper
DDA	Doha Development Agenda
Deplu	Departemen Luar Negeri (Ministry of Foreign Affairs), RI

Deptan	Departemen Pertanian (Ministry of Agriculture), RI
DG	Directorate General
DGIP	Directorate General for Intellectual Property
DGTEC	Directorate General for Trade of the European Commission
EC	European Community (or European Economic Community)
EC Delegation	Delegation of the European Commission to the RI, Brunei Darussalam and Timor Leste
EMERALD	Equilibrium Model with Economic Regional Analysis Dimension
EPA	economic partnership agreement
ESF	European Services Forum
ESM	European Single Market
EU	European Union
EUR	euro
Euratex	European Apparel and Textile Organization
Eurochambres	Association of European Chambers of Commerce and Industry
FDI	foreign direct investment
FEP	foreign economic policy
FTA	Free Trade Agreement/Area
GAERC	General Affairs and External Relations Council
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GPA	Government Procurement Agreement
GSP	Generalized System of Preferences
IDR	Indonesian rupiah
IGJ	Institute for Global Justice
IISD	International Institute for Sustainable Development
IMF	International Monetary Fund
INFID	International NGO Forum on Indonesian Development
IP	intellectual property
IPR	intellectual property rights
JCC	Joint Cooperation Committee
Lao PDR	Lao People's Democratic Republic
LNG	liquid natural gas
KADIN	Kamar Dagang dan Industri Indonesia (Indonesian Chambers of Commerce and Industry)
KRuHA	Koalisi Rakyat untuk Hak atas Air (People's Coalition for Water Rights)
LNG	liquid natural gas
Mercosur	Mercado Común del Sur (Southern Cone Common Market)
MFA	Multifibre Agreement
NAFTA	North American Free Trade Agreement
NAMA	non-agricultural market access

NGO	non-governmental organization
NIC	newly industrialized country
NTB	non-tariff barrier
OECD	Organization for Economic Cooperation and Development
PCA	Partnership and Cooperation Agreement
PSB	private sector barriers
PTA	preferential trade agreement/arrangement
REI	regional economic integration
RI	Republic of Indonesia
RIS	regional integration strategy
SCCAN	Special Coordinating Committee of ASEAN Nations
SIA	sustainability impact assessment
SPM	Special Products MeSpecial Safeguard Mechanism
TCF	textiles, clothing and footwear
TDI	trade defence inst Network
TREATI	Trans-Regional EU–ASEAN Trade Init
TRIPS	Trade-Related Intellectual Property Rights (Agreement)
TURC	Trade Unionsre
UK	United
UNCTAD	UN Conference on Trade and Development
UNICE	Union des Industries de la Communauté Européenne (Union of Industrial and Employers' Federation of Europe; currently known as Business Europe)
U.S.	United States
USD	U.S. dollar
UUPM	Undang-Undang Penanaman Modal (Foreign Investment Law)
WTO	World Trade Organization

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Chapter 1 – Introduction

The relationship between the Association of Southeast Asian Nations (ASEAN) and the European Union (EU) has stood for over three decades. ASEAN and the European Economic Community (or European Community – EC), as it was then called, first established informal relations by means of the 1972 ASEAN Special Coordinating Committee, which made the EC ASEAN's first dialogue partner. Over the last 30 years, relations between the two regional groupings have been coloured by both achievements and setbacks. To ASEAN, the EU has been a model of inspiration for regional integration; similarly, the EU has supported ASEAN in its efforts to strengthen regional integration in Southeast Asia. Despite their long standing partnership, however, ASEAN has featured little in the EU's foreign policy focus; indeed, the EU has paid more attention to its transatlantic relations with the U.S., as well as supporting developing nations in the African, Caribbean and Pacific (ACP) regions. The Asia–Europe Meeting (ASEM), a forum that involves the EU, ASEAN and the Northeast Asian countries, however, has not progressed much because of differing opinions over certain sensitive issues, such as Myanmar's membership of ASEAN. The EU's increased interest in ASEAN in recent years is a result of the latter's new profile in international relations. The European Commission presented its 'Europe and Asia: A strategic framework for enhanced partnership' communication in September 2001 (European Commission, 2001), identifying ASEAN as a key economic and political partner. Subsequently, the European Commission also issued 'A new partnership with Southeast Asia' in 2003 (European Commission, 2003a), a communication that sets out a comprehensive strategy for future relations with Southeast Asian countries. These documents form a stepping stone for the renewed relationship between the two regional groupings.

In order to strengthen economic relations between the two regions, the EU and ASEAN have agreed to draw up an ASEAN–EU Free Trade Agreement (AEUFTA) sometime in the near future. The strengthening of EU–ASEAN economic relations under this arrangement comes at a time when global trade talks under the auspices of the World Trade Organization (WTO) are being challenged not only by the differences among member countries, but also by the rise of bilateral free trade agreements (BFTAs) either between countries, between regional groupings, or between a regional grouping and a country. Indeed, together with its expansion into Eastern Europe, the EU has been actively pursuing BFTAs. Since 1995, for example, the EU has engaged in association agreements with Tunisia, Morocco, Jordan, the Palestinian Authority, Lebanon and Egypt. It has also sealed comprehensive trade agreements with Mexico, Chile, the Southern African Development Community and the Gulf Cooperation Council. ASEAN has also been active in BFTA initiatives in the Asia-Pacific region. It entered into its first BFTA with China in 2004, while BFTAs and economic partnership agreements (EPAs) with other Northeast Asian economic powers, including Japan and South Korea, have either been signed or are currently being negotiated.

As with most BFTAs, the proposed AEUFTA needs to be critically examined. The EU and the U.S.—the former's closest partner—are champions of the so called WTO-plus arrangement in their BFTAs. These new free trade agreements (FTAs) are normally comprehensive, embracing not only the conventional trade in goods, but also areas such as service sector liberalization, investment, intellectual property rights (IPR), competition, public procurement (as opposed to the relatively more limited government procurement) and other issues. The EU, like many other developed countries, is growing increasingly frustrated at the slow progress of global trade talks. With its vast experience of carrying out an enlargement process in the Eastern European region, it is very keen to strike up integration initiatives with countries or regional groupings in the southern hemisphere for the purpose of penetrating new markets.

However, a study conducted by the UN Development Programme (UNDP, 2005: 5) argues that North–South BFTAs tend to generate more benefits for developed countries, and this could prove to be an issue of importance in the AEUFTA negotiations. The incorporation of Trade-Related Intellectual Property Rights (TRIPS)-plus arrangement under an AEUFTA, for example, could further benefit large European pharmaceutical and agroindustrial companies at the expense of the ASEAN (and, in terms of this book, specifically Indonesian) poor. According to one estimate, yearly profits of USD 32 billion have already been generated from drugs supposedly 'discovered' by these companies as a result of their prior use in indigenous medicine (UNDP, 1999). This is not to mention the loss of access and control that would be experienced by ASEAN/Indonesian farmers, such as access and control over seeds, etc., should a TRIPS-plus arrangement become a key component in AEUFTA negotiations.

This study examines the proposed plan of ASEAN and the EU to establish an FTA in the near future. More specifically, it attempts to assess the economic impacts of this proposed arrangement on Indonesia, an ASEAN member country. Although numerous studies have been conducted to analyze the feasibility of an AEUFTA (see, inter alia, Kettunen, 2004; Consortium of Euro-Asia Centre and IFRI, 2006), little critical research on the subject has been carried out, particularly in terms of non-governmental stakeholders in the process.

This introductory chapter sets out (1) the objectives and key hypotheses of the study; (2) the research methodology used to carry out the study; (3) the analytical framework used for discussion throughout the study and a theoretical argument on the importance of developmental perspectives in BFTAs and interregionalism; and (4) the structure of the study.

The objectives and key hypotheses of the study

The analysis in this study is motivated by a desire to identify the actual needs of both Indonesia and ASEAN in establishing the AEUFTA. Its objectives are threefold. Firstly, it seeks to analyze the core motives of the key stakeholders in ASEAN, Indonesia and the EU in forming an AEUFTA. Secondly, it analyzes the main concerns and expectations of different stakeholders in Indonesia, particularly small and medium-sized economic actors. And thirdly, it assesses the potential negative and positive economic and social impacts of this BFTA on Indonesia.

Given the economic imbalance between ASEAN and the EU in the world economy, the study argues that *economic relations between ASEAN and the EU favour the latter. Consequently, the proposed AEUFTA, in order to redress this imbalance, must take into account the development objectives of ASEAN, including those of Indonesia*. As a regional bloc, the EU is becoming an economic entity comparable to the U.S. and often exercises powers beyond those possessed by other global economic superpowers. As Reid (2004: 232) rightly points out, 'the EU rules on labelling, content, manufacture, design, and safety have become the rules that manufacturers must follow all over the world'. Within the EU there are many large multinational corporations with a global reach, many of which are already doing business in the ASEAN market. ASEAN, on the other hand, has not yet evolved into a supranational economic entity capable of competing with the EU at the global level. Regional interests have not yet succeeded in replacing national interests among ASEAN member countries. Consequently, the expected adjustment costs paid by ASEAN and Indonesian economic actors will be high once the AEUFTA is implemented.

Research methodology

The study uses both qualitative and quantitative research methodology. Both primary and secondary qualitative data were collated and analyzed. Research interviews with state and non-state establishments at the national (Indonesia) and regional (ASEAN and the EU) levels were carried out. The key respondents in ASEAN and Indonesia include the ASEAN Secretariat (regional level); economic and trade related government establishments (such as the Indonesian Ministries of Trade, Foreign Affairs, and Agriculture); the academic community (including national think tanks and leading experts on trade and economics); the business community (including the Indonesian Chambers of Commerce and Industry and other smaller business associations); and NGOs (national level). In Indonesia, research interviews were also carried out with officials of ASEAN member countries and the EU's representatives in Jakarta, such as those of the Royal Embassy of Thailand; the Royal Embassy of Malaysia; and the Delegation of the European Commission to the Republic of Indonesia (RI), Brunei Darussalam and Timor Leste.

Qualitative data was also obtained from research interviews conducted with relevant establishments in the EU, such as the Directorate General of Trade of the European Commission; some members of the Article 133 Committee, which is composed of trade policy officials from EU member states who provide technical advice to the European Commission; representatives of some political parties in the European Parliament; and a number of European business associations. The study also includes an extensive literature review of various academic and non-academic publications, such as books; journals; policy papers and reports from various regional and national establishments; newspapers and magazines; and relevant websites.

In contrast to most literature on economic integration, which gives more weight to the Vinerian static (i.e., the changes in the trade patterns of and dynamics among member countries, the structural change in production in member economies, and the effects of free trade arrangements or custom unions; see Viner, 1950), economic impacts in this study are quantitatively measured through the simulation of a computable general equilibrium (CGE) model made specific for Indonesia. This model is called the Equilibrium Model with Economic Regional Analysis Dimension (EMERALD). The basic data or input-output of this model has been modified though the aggregation of all sectors that are expected to be incorporated into the AEUFTA. EMERALD is a useful economic modelling tool for highlighting the economic costs and benefits of Indonesian engagement in the AEUFTA. The economy wide effect of this analysis is composed of macroeconomic and sectoral results, both at the national and provincial levels.[1]

Typology of global trading systems and development in economic bilateralism and interregionalism: An analytical framework

Typology of global trading systems

The structure of global trading systems is more complex today than ever before. There are currently four observable layers of global trade governance, which include trade bilateralism, regionalism, interregionalism and multilateralism. These four layers are highly interlinked and they all affect the new, multilayered economic relationships and governance structures in the world economy (Dent, 2005: 82). Accordingly, each of these layers can sometimes complement and sometimes contradict the others. Someof the terms used to describe these layers, such as bilateralism and interregionalism, are used interchangeably by policymakers, scholars, professionals and activists. To start with, trade bilateralism, also often referred to as bilateral trade agreements/arrangements (BTAs), form the basic level of global

1 For further explanations on EMERALD's core equation, see Pambudi and Chandra (2006).

trade governance. Initially, bilateralism was mainly associated with certain political, economic and social relations between two states. Unlike conventional bilateralism, which involves a mere exchange of ambassadors, state visits, cultural exchanges and security alliances, economic and trade bilateralism today constitutes more diverse and complex issues (Pambudi and Chandra, 2006: 13–14). A BTA is not only an extension of a multilateral trade arrangement, such as the WTO, but is also an economic activity that constitutes regionalism and interregionalism. It is an extension of multilateralism because the conduct of a BTA must not only conform to the rules and standards of the multilateral trade agreement, but also because the issues covered must be at least in line with, or go beyond, those negotiated at the multilateral level. In other words, BTAs must be WTO-plus in nature. BTAs have emerged as a result of, inter alia, the slow progress of the WTO in achieving global free trade—both developed and developing countries have felt frustrated by how little they have gained so far under the WTO. Countries also favour BTAs because such trade mechanisms allow easier preferential access to the parties involved (Lloyd, 2002; Chirativat and Mallikamas, 2005).

Today, BTAs take many forms, including bilateral preferential agreements, BFTAs, bilateral service agreements, and even bilateral customs unions. Moreover, unlike conventional bilateralism, which is associated with economic and trade relations between two states, BTAs can be formed between a state and a regional grouping and between two regional groupings. Some examples of BTAs include the U.S.–Singapore FTA (state-to-state trade bilateralism), the ASEAN–China FTA (region-to-state trade bilateralism) and the proposed AEUFTA (region-to-region trade bilateralism). Another variation of the BTA is the EPA. Generally, an EPA is more comprehensive than a BTA, in that it incorporates wider forms of economic and technical cooperation rather than the simple trade liberalization or market access that is evident in the U.S.-led *asymmetric neoliberal* model of BFTAs (Dent, 2006: 236). In addition, an EPA supposedly has more transformative development objectives than other forms of BTAs. Therefore, apart from including the so-called *broad band* issues, such as IPR, investment, e-commerce, mutual recognition agreements, etc., EPAs also cover other issues, such as cooperation in the area of science and technology, human resource development, etc. Japan and the EU are keen promoters of EPAs. The inclination of Japan, in particular, to embrace an FTA within a wider EPA is a reflection of the country's conflation of trade and aid policies, as well as a projection of Japan's national developmentalism onto a broader regional canvas (METI, 2005). The development objective is also evident in EU led EPAs, particularly those forged with developing or least developed countries.

Meanwhile, the second layer of global trade governance is economic regionalism, also often referred to as regional economic integration (REI), which is 'the process of reducing the economic significance of national political boundaries within a geographic area' (Anderson and Blackhurst, 1993: 1). Alternatively, it may also be 'loosely defined as any policy designed to reduce trade barriers between a subset of countries' (Winters, 1999: 8), and as such reflects the notion within trade theory that a partial move towards freer trade will improve welfare among member states of any REI process. In essence, an economic analysis of regionalism defines regionalism in terms of the movement of capital, goods, services and labour. Economic regionalism is not new, and its post-World War II appearance was triggered by the formation of the European Coal and Steel Community in 1950. Subsequently, throughout the next three decades, or during the so-called *first wave of regionalism*, the world saw the mushrooming of economic regionalism. Latin America, for instance, gave birth to the Central American Common Market and the Andean Community in 1960 and 1969, respectively. Regional organizations that promoted economic integration also mushroomed in Africa, such as the Economic Community of East Africa (1974), the Economic Community of the Great Lake Countries (1976), the Economic Community of West African States (1975), etc. In Asia, however, ASEAN was the only regional organization to emerge during this first wave of regionalism.

The global tendency towards regionalism faded away during the late 1970s, and reemerged during the early 1990s. This *new wave of regionalism* is a post-Cold War phenomenon. It is more heterogeneous in character than the old wave in that it involves a wide range of issues, actors and institutions in the regionalization process (Hettne, 1999a: 7–8; Bhalla and Bhalla, 1997: 21). The growth of economic and trade regionalism was evident in the early 1990s. The evolution of the EC into the EU through the signing of the Maastricht Treaty in 1992 led to a series of other REI initiatives, such as the North American FTA and the ASEAN FTA in 1992, the Southern Cone Common Market (Mercado Común del Sur, or Mercosur) and the South Asian Preferential Trade Agreement in 1995, as well as other regional economic integration initiatives in other parts of the world. The emergence of these new regional initiatives was seen as a spontaneous process by many regionalism scholars in the sense that the initiatives were not instigated only by institutions, but by other actors contributing to the regionalization process. The more positive attitude among global economic policymakers towards the notion of economic openness and liberalization also played a part in fostering the growth of these REI initiatives.

Interregionalism is the third layer of the global economic and trade governance structure. It is more difficult to define because it is quite a new area of research in the field of international politics (Rüland, 2002) and economics, as well as being a newly developed theory within the framework of new regionalism analyses (Olivet, 2005: 7).[2] Consequently, it is difficult to find agreement among scholars on the definition of this term. In general, however, interregionalism can be referred to as the process of institutions and organizations mediating between regions (Hettne, 2004). It represents the interaction of one region with another (Gilson, 2005: 309). The point of departure in the study of interregionalism is the external relations of regional organizations. Hänggi (2006: 34), in particular, argues that as the major actors structuring relations between regions, regional organizations exhibit two basic forms of external relations, which are relations with third countries and relations with other regional organizations. Similarly, Gilson (2005: 309) points out that interregionalism is often portrayed as a *double regional project*, which responds to the need to pool an even greater percentage of resources in recognition of other interregional and global dynamics. In other words, interregionalism is a process of regional emulation that triggers the formation of new regional initiatives, with potentially positive or negative consequences (Hettne, 1999b: xxii).

Scholars and students of regionalism see the nature of interregionalism as comprising two sets of international relationships, i.e., *interregional* and *transregional* relationships. In Rüland's (2001: 5–6) view, for example, the number of regions involved and the character of the relationship distinguish the interregional and transregional character of interregionalism. The interregional character of interregionalism is evident in the group-to-group dialogues of ASEAN–EU relations. The relationship between the two regional groupings is based on a low level of institutionalization, usually at the ministerial, ambassadorial and senior official levels, which is sometimes supported by permanent or ad

2 In trade related matters, however, the term interregionalism can often be confused with economic and trade bilateralism (i.e., BTAs), and many scholars, policymakers, professionals and activists these days use the terms interchangeably. Even more confusing is the fact that the global trade institution with the greatest authority, the WTO, considers all forms of bilateral, regional and interregional trade arrangements as simple regional trade agreements. Is, for example, the proposed AEUFTA a bilateral or interregional trade initiative? Technically, it is both. It is bilateral because, as explained above, BTAs today are not only conducted between states, but also between regional groupings. The AEUFTA is also an interregional initiative because it is an economic arrangement between two regional entities. Yet the lack of clarity around the definition of these terms can create confusion when analyzing greater global economic governance beyond trade issues. It is important to note that both regionalism and interregionalism are concerned with more than just trade. Consequently, it is more appropriate, at least for the purpose of analysis in this study, to see a region-to-region trade initiative such as the AEUFTA as a bilateral, rather than an interregional, trade initiative. However, it is also important to note that a bilateral trade initiative is also an element of broader regional, and, subsequently, interregional, initiatives.

hoc experts' working groups. Discussions during meetings are mostly centred on issues such as the exchange of information and cooperation in specific policy fields (i.e., trade and investment, environment, trafficking, etc.). Meanwhile, transregional initiatives normally have more diffuse memberships that do not necessarily coincide with regional organizations and may include member states from more than two regions. Some good examples of transregional initiatives are ASEM and the Asia-Pacific Economic Cooperation (APEC) forum. Unlike interregional and region-to-region dialogue, transregional initiatives may develop their own organizational infrastructure, such as a secretariat, research centres, etc., along with the expansion of their agenda.[3] For Dent (2003: 224), however, the interregional character of interregionalism implies the relationship between two distinct, separate regions, whereas transregionalism constitutes the establishment of common spaces between and across regions in which constituent agents, such as individuals, communities, organizations, etc., operate and have close associative ties with one another.

Finally, multilateralism is the fourth, and possibly highest, layer of international trade governance, which can generally be described as the 'international trade and exchange between more than two countries without discrimination between those involved' (Bannock *et al.*, 1998: 286). As with trade bilateralism, regionalism and interregionalism, multilateral trade arrangements are also concerned with the discriminatory removal of all trade impediments among participating nations and with establishing certain elements of cooperation and coordination among them (El-Agraa, 1988: 1). The multilateral trade system is best exemplified by the WTO, an international trade organization set up in 1995 that has a membership of 153 countries throughout the world today. Previously, since 1947, global trade arrangements were regulated under the General Agreement on Tariffs and Trade (GATT). Under the WTO, however, trade issues tackled at the multilateral level go beyond trade in goods to include trade in services, IPR, competition, etc.

Economic approaches to bilateral, regional and interregional FTAs

Among the three layers of trade governance structure, it is the theory of trade arrangements at the regional level, rather than the bilateral and interregional levels, that has been more developed. The reason for this is quite obvious. While bilateral and interregional trade arrangements were the phenomena of the final decade of the last millennium, economic regionalism has roots in the post-World War II era. However, the logic of analysis of bilateral and interregional (free) trade arrangements should be consistent with that of REI, particularly in terms of relations with third parties (non-participating states). To start with, traditional international economic theories, such as absolute advantage[4] and

3 In a similar analysis to that of Rüland, above, Hänggi (2005: 3–8) also categorizes three different forms of interregionalism, i.e., (1) relations between regional groupings; (2) biregional and transregional arrangements; and (3) hybrid relations such as those between regional groupings and single powers. As with Rüland, Hänggi describes the EU's group-to-group dialogues with other regional groupings, such as ASEAN, as falling into the first category. Meanwhile, biregional and transregional arrangements are a more recent phenomenon in international relations and can be explained in terms of the new triad (i.e., the triangular relationship among the three main economic regions of North America, Western Europe and East Asia). Finally, interregional relationships between regional groupings and single powers normally take hybrid forms. Initiatives of this kind normally involve not only a single power that has a dominant position in its own region (i.e., the U.S. in North America; India in South Asia), but should also constitute relations between biregional and transregional arrangements (i.e., EU–China/EU–Japan and ASEM).

4 The concept of absolute advantage was based on Adam Smith's most influential work, The Wealth of Nations (1776). Smith analyzed the consequence of economic freedom, covering issues such as self-interest, the division of labour, the function of market and the implication of the laissez faire economy. For a detailed analysis of Adam Smith's works, see also Smith *et al.* (1986).

comparative advantage[5] and the early twentieth century factor endowment theory,[6] are in some respects deficient for bilateral, regional and interregional trade analyses. Such theories have been preoccupied with how individual actions initiate trade and an assumption that information will be perfectly disseminated among economic actors, but fail to address issues around the transfer of goods, technology, and management and marketing skills/techniques.[7]

Economists in general refer to the two different effects of bilateral, regional or interregional (free) trade agreements on multilateral trade arrangements, seeing these phenomena as either stepping stones or stumbling blocks (Bhagwati, 1995).[8] Economic bilateralism, regionalism and interregionalism as stepping stones towards multilateralism are normally equated with open (outward) economic bilateralism, regionalism and interregionalism. Likewise, closed (inward) economic bilateralism, regionalism and interregionalism are seen as stumbling blocks. However, GATT rules specifically regulate the formation of regional integration agreements among countries. Article XXIV, clause 4 of the GATT in particular lays out the prerequisites that must be satisfied before any bilateral, regional or interregional trade arrangements can be formed. The participating countries in such trade initiatives must recognize that 'the purpose of a customs union or a free trade area should be to facilitate trade between the constituent territories and not to raise barriers to trade of other contracting parties with such territories' (GATT, 1947: 41). This particular regulation applies to both old and new trade alliances between countries. Thus, GATT rules have made it clear that the formation of bilateral, regional and interregional trade arrangements should not take place at the expense of multilateralism.

Neoclassical economic analyses of bilateralism, regionalism and interregionalism are generally based on the orthodox theory of REI (Schulz *et al.*, 2001: 10). As mentioned earlier, the underlying concept within the study of REI has been the theory of the *customs union*, which refers to the creation of advanced stages of REI in linear succession, including the formation of a preferential trading agreement (PTA), FTA, customs union, common market, and, finally, economic and political union (Balassa, 1961).[9] Economically, the outcome of bilateral, regional and interregional economic arrangements can

5 The theory of comparative advantage was developed by a British member of parliament and economist, David Ricardo, in the early nineteenth century. For a detailed analysis of Ricardo's work, see Sraffa and Dobb (1951).

6 Factor endowment theory was developed by Bertil Ohlin (1933) in his work *Interregional and international trade*, in which he developed an earlier theory, introduced by his mentor, Eli Heckscher, and his own earlier doctoral thesis. Factor endowment theory is now known as the Heckscher-Ohlin theory and has become the basis for many contemporary economic theories, such as the REI theory developed by Viner (1950) and Balassa (1961).

7 In spite of these shortcomings, these theories have proved useful in providing initial analyses for the development of contemporary bilateral, regional and interregional (free) trade arrangements. This is evident particularly in the development of comparative advantage and factor endowment theories. While comparative advantage theory perfected absolute advantage theory by introducing the term *specialization*, factor endowment theory corrected other previous theories by focusing on land, labour, capital, technology and management. The theory of comparative advantage has underpinned the development of recent REI theories by insisting that global free trade is the *first and best policy* to facilitate free trade. Under global free trade conditions (i.e., tariff free global trade), trade is encouraged through the reduction of tariff levels among all countries. In this context, each country is assumed to produce only the goods that it can produce more efficiently than other countries. This leads to optimally efficient production on a global scale if the neoclassical assumptions of comparative advantage theory hold true, i.e., a constant return of scale, no transport costs, perfect competition market conditions, etc.

8 In the context of the relationship between bilateralism and regionalism, Dent (2005) also raises the question of whether bilateralism is region convergent or region divergent. The same question may also be posed when analyzing the regional–interregional nexus, and also interregional multilateral relationships.

9 To start with, whereas a PTA normally involves the reduction or removal of tariffs on an item-by-item basis, an FTA includes the removal of all tariffs and quotas among participating countries. Subsequently, at the higher level, REI normally entails member countries' imposition of common external tariffs against third countries (customs union), the movement of labour and capital (common market), the unification of economic policy, market regulation, macroeconomic and income distribution policies, the introduction of a common currency (economic union), and, finally, the unification of political entities among member countries (political union). However, since FTAs, whether bilateral, regional or interregional, are the main concerns of the current study, our discussion will be restricted to the FTA stage of REI.

be assessed through *static* and *dynamic* gains analyses. Analysis of static effects, or the net economic welfare, of bilateral, regional and interregional economic arrangements has mainly centred upon Vinerian *trade creation* and *trade diversion* theory (Viner, 1950). A trade creation effect normally occurs when internal trade liberalization among participating countries allows more competitive producers from both participating and non-participating countries to expand their own share of the markets that were once held by the less competitive rivals inside the economically integrated area. This condition should, in theory, lead to greater efficiencies, lower consumer prices and better specialization in each economy's area of comparative advantage. On the other hand, a trade diversion effect emerges when producers from more competitive non-member countries are disadvantaged as a result of the higher external tariffs imposed by member countries against third countries. Meanwhile, the dynamic effect of bilateral, regional or interregional economic arrangements is the extent to which these economic arrangements influence the output growth in sectoral and aggregate levels. The broad areas of dynamic effect include (1) economies of scale (i.e., the extent to which these economic arrangements lead to an increase in a country's specialization and cost efficiencies, which, in turn, creates welfare gains); (2) increased competition and efficiency; and (3) closer collaboration among economic actors (i.e., joint ventures and other forms of economic alliances that can lead to greater transfer of skills and technology) (Dent, 2006: 22).

As mentioned earlier, an FTA normally involves the removal of tariffs and quotas among the countries involved in the bilateral, regional or interregional economic arrangement. An FTA has two basic features, one of which is the ability of each member country to fix its own tariff rates against non-member countries. The second feature is the use of a *country of origin* mechanism as a determination of intratrade. The country of origin mechanism is useful 'to limit trade deflection, [which] is a redirection of imports through the country with the lowest tariff for the purpose of exploiting the tariff differential' (Robson, 1987: 23).[10] In the global context, the formation of FTAs incurs both costs and benefits (Edmond and Verbiest, 2002: 2–3). In terms of benefits, an FTA enables a group of countries to deal with more complex issues of trade and regional cooperation (Freund, 2000). Secondly, an FTA also increases domestic competition, which can lead to greater productive efficiency among domestic producers. As a consequence, the quantity and quality of goods available in the economy improve. These trade agreements may also foster greater economic regionalism among member countries. Such agreements offer countries the opportunity to liberalize their economies on a limited and smaller scale than those agreements made at a multilateral level. In terms of costs, PTAs and FTAs can be used as an easy way out for policymakers who are reluctant to actually commit to trade liberalization measures, but face increasing domestic pressure for trade liberalization. There is also the fear of what Bhagwati (1995) calls the *spaghetti bowl* phenomenon. This refers to a situation whereby products in a particular country enjoy access on varying terms based on their countries of origin. If this occurs, then the fear is that such FTAs can lead to inward looking regionalism.[11]

10 At the FTA level of regional integration, it is true that trade deflection is likely to emerge (Dent, 1997: 27), which is primarily due to the divergent rates imposed on third countries. Thus, trade deflection occurs when member countries with more protectionist external policies are circumvented. As such, 'free trade performs the same function for international trade as competition laws in domestic economies' (Oxley, 1990: 194). Another major constraint in employing an FTA is that it generates unequal prices for the products being offered to consumers. This is mostly due to the price differences among products produced within an FTA region and those imported from non-member countries. As Panagariya and Duttagupta (2001: 41) maintain, the 'free mobility of goods produced within the union ensures there is a single union wide price for them. However, goods imported from outside [an FTA] pay different duty.' Therefore, at this stage, while tariff levels between member countries equalize, tariff levels posed to non-member countries are not yet uniform. This condition normally enables producers to enjoy cheap prices for products coming from other FTA member states. However, this depends on the external tariffs set by member countries towards non-member countries. As a result of the different tariff levels imposed on non-member countries, prices of products coming from these countries will vary greatly. Therefore, producers in a member country can only enjoy cheaper prices for goods coming from other member countries if the former set high external rates on imports from non-member countries.

11 For further analysis on the way country of origin mechanisms enhance protectionism, see, for example, Krueger (1993).

The development objectives of economic bilateralism and interregionalism

The word *development* mainly implies change and refers to the process of political, economic and social transformation within countries (Thirlwall, 1994: 9). It is also associated with the process of improving the quality of human lives (Todaro, 1997). This concept has been largely overlooked in BFTAs and interregionalism policymaking. Since the late 1990s new regionalism analysis has been trying to promote regionalism as a development policy by broadening the concept of development regionalism. In this context, development regionalism can be defined as the 'concerted efforts from a group of countries within a geographical region to increase the complementarity and capacity of the total regional economy as well as finding the right balance between function and territory' (Hettne, 2001: 14). Accordingly, as Hettne (2001: 16) further argues, instead of focusing on the promotion of regional autarky and the creation of trade blocs (or *inward looking development*), more emphasis is placed on the coordination of production, the improvement of domestic infrastructure and making use of the available complementarities as a regional development strategy (or *development from within*). Although countries and regional groupings sign economic treaties for the advancement of economic, political and social development, nonetheless economic bilateralism, regionalism and interregionalism as development policies have been relative failures, which is largely due to excessive concerns with trade (Chandra, 2008: 65). Many bilateral, regional and interregional economic initiatives have all mentioned the word *development* in their stated objectives, but, despite this, have had varied success in realizing such objectives. Success tends to depend on the ability of the countries or regional groupings involved to manage the adjustment costs accrued from such arrangements.[12]

The extent to which economic bilateralism, regionalism and interregionalism promote economic development is still a matter of intense debate among scholars, policymakers, development practitioners and activists. Scholars such as Venables (2003), Bhattacharyay and De (2005), and Bhattacharyay (2006) have argued that one of the key instruments for economic development and poverty reduction is regional cooperation and integration. Similarly, Slocum-Bradley (2006) also argues that regional cooperation has great potential to support human and economic development, while protectionist measures risk impeding such development. Countries are pursuing economic bilateralism and interregionalism in order to promote development. At the domestic level, Chandra (2008: 65–67) states that the primary motive for nationalists to pursue what he refers to as a regional integration strategy (RIS) is the promise of sustained economic development. Nationalists today, as Chandra (2008: 65) further points out, are not solely associated with the promotion of protectionist policies, but are keen to pursue trade liberalization measures.[13] Moreover, in a multicultural society, economic development through RIS, particularly through trade liberalization mechanisms, not only stimulates prosperity and wealth throughout a particular country, but also reduces ethnonationalist sentiments. Therefore, an RIS or trade liberalization mechanism may appeal to nationalists as a way of stimulating economic growth and appeasing nationalist sentiments among the members of the ethnonation.

12 Some literature links regionalism and development, notably development integration theory, which has focused on two sets of distributive instruments that promote economic development, namely compensatory mechanisms (i.e., transfer tax systems, budgetary transfers, etc.) and corrective mechanisms (i.e., planned industrial strategies, common investment codes, etc.) (Schulz *et al.*, 2001: 11). For further analysis of development integration theory, see also Axline (1977), Robson (1987: 198–214) and Haarløv (1988: 23).

13 For some scholars, such as Crane (1999), Shulman (2000), Helleiner (2002) and Pickel (2003), one main factor behind this transformation is that nationalists have had to change or adjust their strategies to bolster national power, prestige and prosperity in an increasingly economically interdependent world.

As mentioned earlier, some developed countries and regional groupings are keen to emphasize developmental objectives in their bilateral and interregional economic arrangements. Japan and the EU are cases in point. The developmental aspects of Japan's EPAs are a reflection of that country's developmental political economy, which is linked to the pivotal role of the state in achieving transformative economic objectives in partnership with businesses and civil society groups (Ogita, 2003; Aoki, 2004). This is why Japan prefers its bilateral economic arrangements to be EPAs instead of FTAs. Under the Japan–ASEAN Comprehensive Economic Partnership, which was signed in December 2003 in Tokyo, for instance, ASEAN and Japan agreed not only to enhance trade and investment cooperation, but also incorporated into the agreement various economic, political and security and social cooperative measures. Japan is also committed to the idea of integration in ASEAN in that it seeks to narrow the development gap among the grouping's 10 member countries (Dent, 2006: 236).

The EU also emphasizes the developmental aspects of its bilateral economic initiatives. An EPA, according to the EU, is an instrument to foster development through trade liberalization and the establishment of the right policy framework for such liberalization and to attract investment (Dihm, 2005; European Commission, 2005). The benefits accrued by developing countries are not only generated through trade and investment liberalization in the countries themselves, but also between the developing countries and the EU. Accordingly, the development package offered by the EU normally comprises an increase in market access for developing countries and less developed countries to the EU market, as well as various forms of support to promote economic integration among the developing countries. Learning from its own economic integration experience, the EU is aware that the integration of developing and less developed countries with the EU, as well as integration among developing and less developed countries themselves, should create dynamic gains. Such gains might include an increase in economies of scale, reduced prices and the wider variety of product options associated with an increase in competition among producers in an FTA area, as well as an increase in the transfer of technology and skills. The EU's Cotonou Agreement with the ACP group exemplifies the use of development as the forefront of a bilateral/interregional economic relationship (Scollay, 2006: 1–2). Article 34 (1) of the Cotonou Agreement, for example, states that

> economic and trade co-operation shall aim at fostering the smooth and gradual integration of the ACP states into the world economy, with due regard for their political choices and development priorities, thereby promoting their sustainable development and contributing to poverty eradication in the ACP countries.[14]

In East Asia, ASEAN, Japan, China, South Korea, Australia, New Zealand and India, under the First Asian Summit initiative held in Kuala Lumpur in 2005, issued a declaration that highlighted the importance of strengthening bilateral and multilateral interaction and cooperation on issues of common interest in order to enhance peace and economic prosperity. This declaration contained references to promoting development, narrowing the development gap in East Asia, eradicating poverty through technology transfer and infrastructure development, promoting capacity building, enhancing good governance and providing humanitarian assistance. It also made reference to promoting financial links, trade and investment expansion, and liberalization (Bhattacharyay, 2006: 15). Development was also a catchphrase in the Manila Action Plan, which was adopted by APEC in 1996. This agreement set out six priority themes for APEC, which include (1) the development of human capital; (2) the development of stable, safe and efficient capital markets; (3) harnessing technologies for the future; (4) safeguarding the quality of life through environmentally sound growth; and (5) the development and strengthening of the dynamism of small and medium-sized enterprises (Scollay, 2006: 10).

14 As quoted in Bilal and Rampa (2006).

However, the trade–development nexus is perceived differently not only among different countries, but also among different actors within a country. In the multilateral trade framework promoted by the WTO, for example, developed and developing countries often hold different opinions as to how development objectives can be achieved under a global free trade regime. While negotiators and officials from developed countries insist that development can only be achieved through comprehensive trade liberalization that covers all sectors (agriculture, industry, services, etc.), developing and less developed countries argue that, given the different level of economic development between rich and poor nations, certain flexibilities should be granted. This might include different coverage and schedules for the liberalization of poorer countries. This is demonstrated in the WTO non-reciprocal commitment in the area of non-agricultural market access (NAMA) negotiations. Although the EU has in the past called on all developed countries to grant tariff and quota free access for all products from less developed countries, as well as allowing less developed and developing countries to follow different timetables for the implementation of their tariff cutting commitments, many developing countries have been aware that their markets could be flooded by goods from developed countries under the existing NAMA negotiation modality (ICTSD and IISD, 2003). By committing more deeply to NAMA, it can be argued that developing countries are risking the prospect of deindustrialization and the loss of significant revenues from the imposition of tariffs (Friends of the Earth, 2004: 5), both of which impact negatively on their economic development.

Similar development dilemmas also emerge in bilateral and interregional trade initiatives. Once again, the EU–ACP EPA arrangement can be used as an example of how development is perceived differently by the two sides. While the EU argues that development is achieved through trade and investment liberalization, the ACP countries believe that an EPA can be beneficial only if it is 'economically meaningful, politically sustainable and socially acceptable' (Bilal and Rampa, 2006: 44). For the ACP countries, trade liberalization and regional integration alone are not enough to foster development and alleviate poverty. NGOs are also critical of EPAs. The Stop EPA Campaign (2004), set up by a coalition of NGOs from Europe and the ACP countries, has criticized the current EPA between the EU and ACP as highly risky and not development friendly.

In the context of trade relations between ASEAN and the EU, the EU is the more dominant global economic actor. Although there is a disparity in economic development among EU member countries, the gaps are even greater among ASEAN member countries. Domestic problems, such as the poor quality of human resources, uncompetitive domestic industries, poor technological skills, weak legal enforcement, etc. still plague most ASEAN member countries, including Indonesia. What this study seeks to analyze, therefore, is whether the proposed AEUFTA will be *development convergent* or *development divergent*.

The structure of the report

The study is divided into six chapters, each dealing with specific issues relevant to the AEUFTA. Chapter 2 analyzes the political economy of the ASEAN (Indonesia)–EU relationship. The Southeast Asian region has a long history in international trade (Dent, 1999: 37) and has been much exposed to European influences through colonization and subsequent economic relations after World War II. Politically, the clash over norms and values has often undermined the relationship between the two regions. The relationship is unique, however, in that it was one of the earliest interregional relationships.

Chapter 3 analyzes the trade regimes and policymaking processes in ASEAN (Indonesia) and the EU. It begins with an analysis of the trade and investment patterns between ASEAN (Indonesia) and the EU, followed by an analysis of trade and investment regimes in both regions. It also examines how policy regarding the proposed AEUFTA is formulated in both ASEAN (Indonesia) and the EU. On the EU side, the integration of Western European countries does not necessarily mean a simplification of the European governing structure. Indeed, there is still a need to balance power between EU member states and regional institutions. With 30,000 Eurocrats (or *fonctionnaires*, to use Brussels' preferred terminology), the EU's governing structure can be described as a jungle, with its 'ridiculously complicated structure of European Union councils, commissions, courts, committees, and parliament scattered around the various European cities' (Reid, 2004: 272). Yet, as Reid also argues, this 'awkward, ugly beast ... somehow manages to perform its necessary functions in a difficult environment,' including the formation of a complex trade policy.

Unlike the EU, ASEAN is far from reaching full integration. Despite this, as it moves towards the formation of the proposed ASEAN Community in 2015, discussions on the establishment of an ASEAN Charter show that the association is beginning to develop a legal personality.[15] It remains to be seen how the evolution from nation state to regional state takes place, since most countries still zealously guard their national interests. With regard to the trade policymaking process, however, ASEAN's decision to pursue an AEUFTA policy is a reflection of the desires of national governments, although some of the initiatives have come from the ASEAN Secretariat in Jakarta. Chapter 3 also examines the way in which trade policymaking is pursued in Indonesia. Although Indonesian trade policy is national in nature, it is by no means less complex or bureaucratic than the EU's. Indeed, the lack of coordination among government ministries and the ad hoc nature of government–civil society dialogue on trade policy issues have helped to make Indonesian trade policy rather vague. However, recent initiatives, including the formation of the Indonesian International Trade Negotiation National Team (Tim Nasional Perundingan Perdagangan Internasional), have been instrumental in better coordinating trade policymaking processes in the country.

Chapter 4 provides a quantitative assessment of the economic impacts of the proposed AEUFTA on the Indonesian economy. This quantitative analysis is measured through a simulation of a CGE model specific for Indonesia, known as EMERALD. This analysis highlights some of the potential costs and benefits to the Indonesian economy as a result of the country's engagement in the proposed AEUFTA. Two scenarios are presented. The first examines an economic condition where the AEUFTA allows a 10 percent increase in capital inflows from the EU into Indonesia. In the second scenario, we simulate an economic situation where the AEUFTA has increased Indonesian exports to the EU by 18.5 percent. The simulation of these scenarios yields different results and provides a sound basis for the policy recommendations in the final part of this study.

Chapter 5 explores in detail the perspectives of region state, state and non-state actors on the proposed AEUFTA. The analysis in this chapter is based on the results of extensive research interviews with key actors in the EU, ASEAN and Indonesia. Chapter 6 revisits the project's key findings and puts forward recommendations and proposals for ASEAN and Indonesia trade policymakers to consider before entering into the AEUFTA negotiations.

Concluding remarks

It is hoped that the analyses provided in the following chapters will provide a new perspective on the complex issues surrounding the proposed AEUFTA. Through this study, the research team hopes to provide an alternative paradigm to the existing analyses of bilateralism, regionalism and interregionalism. It is the sincere hope of the authors that the research findings of this study can be a valuable input for both ASEAN and Indonesian trade policymakers.

15 The proposed ASEAN Community will have three pillars: the ASEAN Political Security Community, the ASEAN Economic Community and the ASEAN Socio-cultural Community.

Chapter 2 – The Political Economy of the ASEAN (Indonesia)–EU Relationship

Introduction

The countries of Southeast Asia and Europe have a long standing relationship. For centuries, Southeast Asia has attracted the interest of European missionaries, traders and political expansionists (Lach, 1965; Gilson, 2002: 31), while the British, Dutch, French, Portuguese and Spanish empires all had interests in Southeast Asia. The term *Southeast Asia* itself is of recent, European origin. It was initially used for strategic purposes by the British and Allied supreme commander in the region, Lord Louis Mountbatten, during World War II (SarDesai, 1997: 3).[16] After the war, relations between Europe and Southeast Asia broke down as Europe faced the economic challenge of post-war restoration, while Southeast Asian states faced the challenge of newborn nation statehood. The opportunity to strengthen the link between Europe and the countries of Southeast Asia arrived with the establishment of ASEAN in 1967. ASEAN and the EC established informal relations in 1972, which made the EC ASEAN's first external partner. Over the last three or so decades, the relationship between the two regional groupings has evolved quite dramatically from one based on development and diplomacy to one based on non-traditional diplomacy (e.g., cultural exchanges, etc.) and regional integration. The growing influence of Europe after the signing of the Maastricht Treaty in 1992, coupled with its waning interest in Southeast Asian development, has led ASEAN decision makers to find a new direction in trade relations. ASEM was established in 1996. Its membership included the 15 EU countries; the European Commission; and the seven ASEAN countries; plus China, Japan and South Korea. The inclusion of the latter three countries made the EU pay more serious attention to the ASEM forum, while ASEAN saw ASEM as a much needed vehicle to gain more prestige and level its bargaining position with major economic powers (Rüland, 2001: 22).

Despite these developments, the lack of political will and other forms of institutional support have created little incentive for ASEAN–EU dialogue to grow. The political row between Brussels and Jakarta (where the ASEAN Secretariat is located) over Jakarta's handling of Myanmar affairs and other human rights and democracy issues clouded much of initial ASEAN–EU relations. In recent years, however, ASEAN's constructive role in promoting regionalism and the EU's interest in engaging further with the Asian economic giants, particularly China and India have made ASEAN one of the main pillars in the EU's Asia policy. It is for these reasons that Jakarta's request to commence negotiating the AEUFTA was eventually granted by Brussels. Although the AEUFTA will certainly open the gates for further economic engagement and cooperation between the two regions, it remains to be seen if the economic impacts of this trade agreement can also produce a positive spillover effect in institutionalizing the relationship between ASEAN and the EU. Despite the tendency of policymakers in ASEAN and the EU to use BFTAs as a diplomatic tool, such agreements are still highly contested by civil society groups in each region.

16 From a strategic point of view, the Allied forces realized that the Southeast Asian region was different from India, China and parts of the Pacific. They perceived the need for a new geographical unit to include Brunei, Burma, Laos, Thailand, Cambodia, Vietnam, Malaysia, Singapore and Indonesia (Osborne 1997: 4). The omission of the Philippines in the composition of early Southeast Asia was deliberate. There was intense debate among scholars as to whether this country was part of the geographical unit, and early Southeast Asian studies, such as Hall's (1968), excluded the Philippines from the geographical unit because it lay outside the region's mainstream of historical development.

The objective of this chapter, therefore, is to analyze the character of the ASEAN–EU relationship throughout its evolution. This analysis should provide a much needed background for deeper discussions about the AEUFTA, which will be examined in more detail in subsequent chapters. The analysis in this chapter is divided into six sections. The next section provides a historical perspective of the ASEAN–EU relationship, analyzing the ASEAN–EU relationship from the establishment of informal dialogue between the two regions in 1972 up to the present day. The third section briefly analyzes the evolution of the ASEAN–EU relationship from interregionalism to transregionalism in the form of ASEM. Furthermore, since Indonesia is used as a case study in the analysis of the economic impacts of the AEUFTA, particular attention is paid to the role that Indonesia plays in ASEAN–EU relations. The fourth section specifically addresses this role. The fifth section analyzes the extent to which a BFTA can serve as a means to enhance the partnership between ASEAN and the EU. Finally, some concluding remarks highlight the chapter's key findings.

A historical perspective on the ASEAN–EU relationship

There can be little doubt that Europe has been much more important to ASEAN than ASEAN to Europe (Rieger, 1991: 38). This has always been the case, from the first interregional dialogue between ASEAN and what was then the EC, up to the expansion of the ASEAN–EU relationship through transregional forums such as ASEM and the more recent call to create an AEUFTA. Over the last three decades, the focus of Europe–ASEAN cooperation has transformed from a development emphasis, where Europe provided much needed aid for Southeast Asian development, to an emphasis on diplomacy, where the two sides discussed regional and international problems, and finally to a new emphasis on non-traditional risks and regional integration support (Möller, 2006: 3). Indeed, after informal relations began between the EC and ASEAN in 1972, and the subsequent formalization of the relationship between the two regional groupings eight years later, much of the Europe–Southeast Asia relationship has focused on Southeast Asian development. The dismantling of bipolarity after the Cold War somehow gave new direction to the relationship between the two regions. This relationship evolved into transregionalism in the form of ASEM, which included wider state actors in East Asia, while new areas of cooperation were discussed to tackle global problems and strengthen ASEAN's own regional integration initiatives. Despite this, the interregional relationship between the two groupings remained 'bumpy' (Rüland, 2001). It was only because ASEAN began playing an increasingly central role throughout the latter part of the 1990s and beyond to promote Asian regional cooperation that the EU started to see it as its main focus in its relations with Asia. It was for this reason that ASEAN's requests to forge an AEUFTA were granted by the EU in the new millennium.

In the early 1970s, three key factors pushed ASEAN to develop more constructive relations with the EC. Firstly, some key ASEAN member countries, particularly Singapore and Malaysia, were alarmed by the potential loss of their Commonwealth trade preferences as a result of British membership of the EC (Sanitwongse, 1989; Bridges, 1999; Yeung *et al.*, 1999: Rüland, 2001). Secondly, most ASEAN economies were also excluded from the EC's Lomé Convention arrangement that provided least developed countries with special access to the EC market (Tulloch, 1973). The final factor was the growing tendency towards protectionism in Europe as a result of two major oil crises in the 1970s and 1980s. ASEAN moved quickly to respond to these global economic transformations. By 1972 it had set up the Special Coordinating Committee of ASEAN Nations (SCCAN), consisting mostly of ASEAN trade ministers, with the objective of conducting institutionalized dialogue with the EC, as well as improving the group's position in the hierarchy of the EC's preferential trade arrangements. Later that year, ASEAN also established the ASEAN Brussels Committee (ABC), comprising ambassadors from ASEAN member states accredited to the EC. The task of the ABC was to assist the work of the SCCAN, as well as to meet regularly with EC officials on a range of issues. Similar ambassadorial committees were later established in other important European capitals, such as Bonn, Paris and London.

The response of the EC towards ASEAN's request for a formal relationship was relatively positive. Dent (1997: 46) has pointed out the two key reasons for this. Firstly, the entrance of Britain into the EC prompted the community to reevaluate its relationship with the countries of Southeast Asia as part of a broader reassessment of its relations with developing countries. By July 1971, the EC became the first economic superpower to adopt the Generalised System of Preferences (GSP) scheme, which provided favourable trade concessions to countries that were excluded from its Lomé Convention arrangement. Secondly, the EC's European Political Cooperation Policy and Common Commercial Policy—which guide the EC in its political and economic relations with third countries—began to take shape. Consequently, ASEAN's request created an opportunity for the EC to develop its role as a credible actor in international affairs.

After informal ASEAN–EC relations were established in 1972, both sides agreed to formalize relations through a Joint Study Group in 1975, which was intended to oversee greater cooperation between the two sides (Möller, 2006: 2). At the same time, the ABC had entered into regular dialogue with the Committee of Permanent Representatives of the EC Council of Ministers (Rüland, 2001: 13). After the announcement of the establishment of formal ASEAN–EC ties in 1977, a fully fledged international dialogue began to emerge (Chiang, 1981: 330; Teo, 1985: 118). In the following year, for example, through the initiative of the German and Thai governments, the first ASEAN–EC Foreign Ministerial Meeting was convened, and in 1980 both sides signed the core ASEAN–EU agreement, known as the ASEAN–EC Cooperation Agreement, in Kuala Lumpur, Malaysia.[17] This agreement remained the major pillar of ASEAN–EC, and, subsequently, ASEAN–EU, relations. It not only spelt out the objectives for technical and economic cooperation between ASEAN and the EC, but also called for the establishment of a Joint Cooperation Committee (JCC) to monitor the implementation of the many agreements signed by the two sides. For the EC, the ASEAN–EC Cooperation Agreement was classified as a *second generation* agreement, in contrast to the subsequent agreements made by the EC with some Central and Eastern European and Latin American countries (Dent, 1997: 48).[18] These second generation agreements normally included provisions on trade and development cooperation, the promotion of investments, joint ventures, and other economic issues, such as the transfer of technology, etc. In addition, under the ASEAN–EC Cooperation Agreement, the EC also extended most favoured nation treatment to ASEAN countries, as a way of complementing the GSP concessions given to ASEAN. The ASEAN–EC Cooperation Agreement later became the model for other EC interregional relationships, such as the EC's relationship with the Andean Community (1983), Central American countries (1984), the African Frontline States and the Gulf Cooperation Council (1986) (Regelsberger, 1989: 88; Lukas, 1989: 103).

Over time, more intensive interregional dialogues took place between ASEAN and the EC. Ministerial meetings were conducted every 18 months from the early 1980s as part of the ASEAN Post-Ministerial Conference—a consultation that ASEAN holds annually with its external partners after its own annual ASEAN Foreign Ministerial Meeting. Interregional dialogues have also taken place at the parliamentary level (Rüland, 2001: 13). As with the ministerial meetings, dialogues between the European Parliament and the ASEAN Inter-Parliamentary Organization (AIPO)[19] were held every 18 months. However, as Dreis-Lampen (1998: 144) has pointed out, interparliamentary discussions have been far from smooth

17 Details of the ASEAN–EC Cooperation Agreement are available in Appendix 1.

18 Democracy and human rights are key provisions in many of the later, or *third generation*, agreements.

19 AIPO is currently known as the ASEAN Inter-Parliamentary Assembly.

because of members of the European Parliament's continuous criticisms of ASEAN regarding its lack of democracy and poor human rights records.[20]

Despite great diplomatic effort to strengthen the relationship between ASEAN and the EC, Asia ranked relatively low among the latter's foreign policy objectives. To policymakers in Brussels in the 1970s and 1980s, ASEAN had already fallen into the U.S. sphere of influence (Regelsberger, 1989). Although trade and investment relations did flourish throughout the 1970s, other kinds of relations remained limited. The EC's offer, for example, of a mutual commercial arrangement between the two sides in 1974 was duly rejected by ASEAN, which was searching for assurances from new potential allies in its international relations instead, and was unhappy that the EC refused to incorporate a political dimension in this arrangement (Dent, 1997: 46). The 1980 ASEAN–EC Cooperation Agreement, according to Rüland (2001: 14), also failed to establish a special relationship between the two organizations. Although it sought to strengthen economic cooperation through, for example, the adoption of mutual respect, non-discriminative treatment, trade facilitation and diversification, the reduction of tariffs and non-tariff barriers, and development, the institutionalization of ASEAN–EC relations was a marginal influence on this process.

During the years immediately after the formalization of ASEAN–EC cooperation, interregional relations could not improve ASEAN's position in the EC's GSP hierarchy, as the ACP and Mediterranean countries were still in the prime position. Under the GSP scheme, selected exports from beneficiary countries could enter the EC free of tariffs, but were still subject to quantitative restrictions, which could become more stringent in accordance with a product's degree of sensitivity (Dent, 1997: 53). Although it might be expected that the GSP scheme would have assisted ASEAN's efforts to penetrate the EC market, several studies found that this was not the case. Langhammer (1982), for instance, found that ASEAN's export performance was better in the U.S. than in the EC, despite the fact that the U.S. did not have any similar GSP scheme. Meanwhile, other studies, such as those conducted by Corbet (1982) and Ariff (1989), found that restrictive rules of origin, low quota provisions and high administration costs were features of the EC's GSP scheme.[21] Despite the presence of this scheme, ASEAN could not push for a price stabilization scheme and better market access for its agricultural products into the EC market.[22] In addition, the quota regulations and voluntary export restrictions attached to the Multifibre Agreement (MFA) also restricted the exports of ASEAN textiles, a sector where ASEAN has comparative advantage, to the EC market.[23] EC developmental aid to ASEAN also remained lower than the aid granted to the ACP countries. To a large extent, economic relations between ASEAN and the EC at the time constituted an asymmetrical donor–recipient relationship (Indorf, 1987: 91). Between 1980 and 1989, for example, ASEAN's proportion of trade in the EC increased by a mere 0.5 percent, from 2.6 percent to 3.1 percent, while EC trade in ASEAN grew by as much as 15 percent (Akrasanee, 1982: 25–26).

At the beginning of the post-Cold War period in the early 1990s there was little change. EC member countries, preoccupied with a desire to strengthen regional economic integration among Western

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20 As quoted in Rüland (2001: 14).

21 Some adjustments made in the late 1980s to the EC's GSP scheme further narrowed the scope of benefits enjoyed by ASEAN. This is particularly true in the so-called *accentuated differentiation* provision that limited GSP concessions to non-sensitive sectors.

22 Despite this, ASEAN was one of the main beneficiaries of the EC's GSP scheme, capturing a staggering 42 percent of all EC trade with developing countries (Bridges, 1999: 77).

23 The MFA was launched in order to replace the Long-Term Agreement on Cotton Textiles. Under this agreement, textile and clothing producers in developing countries agreed to restrain their exports to their developed country partners so as to allow the latter to make the necessary adjustment in their own industry to position themselves better in a more competitive environment (Bannock *et al.*, 1998: 285). The first MFA was put in place in 1974 and was renewed subsequently in 1978, 1982 and 1986. The fourth MFA expired in 1991. Under the second MFA (1977–81), Indonesia and the Philippines became subject to restrictions for the first time. The MFA was phased out in 2005 as part of the Uruguay Round agreement on multilateral trade.

European states, paid little attention to their relationship with ASEAN. The signing of the Maastricht Treaty in 1992 did not only give a new name to the EC—the EU—but also set a schedule for the establishment of a European Single Market (ESM) and a Europe-wide currency, the euro (Reid, 2004: 70).[24] Apart from diverting the attention of EU member countries from their relations with ASEAN, the strengthening of regional integration in Western Europe also created a sense of fear among policymakers in Asia, and in ASEAN in particular, over the possible creation of a *Fortress Europe*.[25] It was feared that the ESM would raise more barriers for imports to the EC market. In addition, during the time of the Uruguay Round multilateral trade negotiations, the EC's Common Agricultural Policy, with its widespread and diverse subsidy programmes, made many Asian countries, including ASEAN members, engage more with the U.S. than the EU (Park and Kim, 2005: 6).

Moreover, the end of bipolarity also created a new clash between West and East. By the early 1990s many Western countries, including EU members, had embarked on a policy of conditionality that linked development with the application of so-called *Western values*, such as democracy, human rights, a market economy, etc. Some political leaders in Asia, such as Lee Kuan Yew of Singapore, Dr Mahathir Muhammad of Malaysia and Suharto of Indonesia, saw the emergence of these Western values as a new form of neocolonialism and hegemony. While prior to the early 1990s democracy and human rights featured little in ASEAN–EC relations, such values began to challenge the relationship during the post-Cold War period. Clashes were evident during the 1991 Ninth ASEAN–EU Ministerial Meeting (AEMM) in Manila. The attempt to revitalise ASEAN–EC economic relations was overshadowed by the persisting conflict between Indonesia and Portugal over East Timor, which was annexed by Indonesia in 1975. The Indonesian government was accused by Portugal of having committed human rights violations in East Timor, and Portugal opposed the EC making any arrangement that would confer advantages on the Suharto regime.

The turning point in ASEAN–EU relations came at the Eleventh AEMM, held in Karlsruhe, Germany, in September 1994. It was here that the EU expressed its willingness to return to more pragmatic policies and tone down the value related issues (Rüland, 2001: 19) that hampered relations in the early 1990s. Accordingly, the meeting concentrated mainly on common economic interests, while putting aside more sensitive political questions. Some significant outcomes achieved in Karlsruhe included (1) the consensus that EU–ASEAN economic relations should be founded on the principle of greater equality and partnership; (2) the creation of an ASEAN–EU Eminent Persons Group, with APEC as a model; (3) a mutual commitment to implement the provisions agreed at the Uruguay Round of GATT negotiations; and (4) an emphasis on human resource development, environmental issues, the fight against drugs, AIDS prevention, poverty alleviation efforts, and the promotion of cultural and media exchange and cooperation in the development package of the agreement (Dent, 1997: 59).[26]

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24 The first phase of the implementation of the Maastricht Treaty in 1994 saw the establishment of the European Monetary Institute, which designed and created the euro, as well as deciding which countries were allowed to use it. The euro was launched as an official monetary instrument at the start of the second phase of the Maastricht Treaty on 1 January 1999, although only in *virtual* form for securities, business transactions and bank accounts. The third phase, which started on 1 January 2002, saw the launch of actual euro coins and bills, followed shortly by the demise of the traditional currencies of EU member countries who had decided to use the euro.

25 The launching of the ESM had indeed caused much speculation and genuine fear about the creation of a 'Fortress Europe.' This fear emerged when the internal market programme was launched in the mid-1980s. The EC's White Paper of 1985 failed to give serious consideration to the external dimension of the internal market. The absence of external considerations was (in the 1985 White Paper) to a large extent a deliberate attempt to sidestep a potentially controversial issue at a delicate stage of intra-EC negotiations (Tsoukalis, 1997: 237).

26 Further information on the Eleventh AEMM is available on the official website of the ASEAN Secretariat, <http://www.aseansec.org/9395.htm>.

Earlier in 1994 the European Commission (1994) issued a communication entitled 'Towards a new Asia strategy,' which was approved during the 1994 EU Summit and in the European Parliament the following year. This policy paper made ASEAN the major pillar of the EU's relations with Asia. This so-called New Asia Strategy, which was later revised in 2001, was launched in the midst of both deepening regional integration in Europe and the prolonged Uruguay Round negotiations (Park and Kim, 2005: 7). This document called for the EU to (1) take part in the dynamic economies of ASEAN; (2) enhance its direct investment in ASEAN countries; and (3) upgrade its relationship with ASEAN. In 1996 another communication was issued by the European Commission (1996) entitled 'Creating a new dynamic in EU–ASEAN relations,' which called for deeper political dialogue, cooperation in international forums and enhanced economic cooperation between the two sides.

Myanmar's admission to ASEAN in 1997 and the economic crisis in the same year further strained the relationship between ASEAN and the EU. ASEAN's decision to accept Myanmar as a new member resulted in the suspension of the AEMM and JCC, both of which resumed in 1999. Moreover, the fact that Europe paid scant attention to ASEAN when some of its members were hard hit by the economic crisis also strained the relationship. However, at the start of the new millennium, new arrangements were proposed to enhance cooperation between ASEAN and the EU, and the EU adopted a number of important measures to better engage with ASEAN. Meanwhile, ASEAN was able to keep afloat in spite of the economic crisis, and managed to make headway, particularly with regard to Asian regional cooperation. It was for this reason that the EU started to prioritize its relations with ASEAN. In 2001, the European Commission (2001) produced an Asia strategy paper entitled 'Europe and Asia: A strategic framework for enhanced partnership,' which set out relations with ASEAN as a key priority. In 2003, the European Commission (2003a) launched another strategy paper entitled 'A new partnership with South East Asia,' which not only identified as key priorities stability in Southeast Asia and the fight against terrorism, but also called for a Trans-Regional EU–ASEAN Trade Initiative (TREATI) as a response to ASEAN's demand to establish a BFTA between the two blocs. This paper also proposed a regional EU–ASEAN dialogue instrument to cover non-trade aspects of interregional cooperation. Subsequently, the EU–ASEAN Vision Group, comprising experts from both sides, concluded in 2006 that a BFTA should indeed be pursued by the two regional groupings.[27]

From interregionalism to transregionalism: ASEAN–EU relations in ASEM

Apart from the strengthening of the existing regional groupings and new regional integration initiatives, the 1990s also saw the emergence of transregionalism. A transpacific, transregionalism initiative, APEC, was set up in 1994, comprising East Asian, and North and South American states. This led to other transregional initiatives, such as ASEM. Established in 1996, ASEM is mainly an informal dialogue and cooperation process that initially brought together the European Commission, the member states of the EU and ASEAN (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand), plus China, Japan and South Korea. It was only in 2004 at the Fifth ASEM Summit that the newer members of ASEAN, including Cambodia, the Lao People's Democratic Republic (Lao PDR) and Myanmar, participated in the forum. The idea for ASEM was first mooted by one of ASEAN's former leaders, Prime Minister Goh Chok Tong of Singapore, in Davos at the World Economic Forum in 1994. The Europeans also played a part in launching ASEM. According to Camroux (2006: 5), it remains an open debate as to whether France or Germany played the greater role in the founding of ASEM.

27 The move(s) towards the formation of a BFTA between ASEAN and the EU will be discussed further in later parts of this chapter.

Documentary evidence gives weight to Germany, particularly as a result of its publication of *The federal government concept of Asia*,[28] which later became the backbone of the EU's New Asia Strategy. This strategy has been described briefly in the previous section.

For many scholars, ASEM has been described as an attempt to find the missing link between Europe and Asia (Camroux, 2006: 4). This missing link refers to the absence of Asia–Europe relations amid the transatlantic and trans-Pacific links in the so-called *Triadic* power equation (Roloff, 1999; Hänggi, 1999). Indeed, despite long historical links between the two regions, little has been achieved in the promotion of political, economic and cultural cooperation between Asia and Europe. As mentioned earlier, up until the early 1990s the EU did not have sufficient energy and resources to design and implement a strong foreign political and economic strategy with regard to Asia because of a preoccupation with its own internal integration programme. Despite the fact that the EU invested heavily in their region, most Asian countries looked more to Washington than Brussels for global engagement. Hard core realists, however, have seen ASEM as a means to balance this out (Rüland, 2001: 22–23). For many European policymakers, U.S. activism with its Asian counterparts in APEC should be balanced by a similar Asia–Europe arrangement, or else by revitalizing Europe's transatlantic partnership with the U.S. Many European countries also paid close attention to ASEM because of China's, Japan's and South Korea's participation. For Asians, on the other hand, ASEM is seen as a counterbalance to extensive U.S. interests in the Asian region, and also to the New Trans-Atlantic Agenda of 1995,[29] arranged between the EU and the U.S. In addition, Asian policymakers saw that better engagement with Europe was essential, given the possible creation of a Fortress Europe that would lead to trade being diverted away from Asia.

Overall, the nature of the dialogue and discussions within the ASEM framework is quite different from other transregional initiatives in the world, particularly APEC. Unlike APEC, where discussion centres primarily on economic cooperation, ASEM pursues a broader format of cooperation (Rüland, 2001: 26) in that it incorporates political and cultural cooperation as well (European Commission, n.d.a). While many of the recent discussions under the APEC framework have had to go beyond the initial mandate (e.g., terrorism, etc.), ASEM member countries are already more comfortable than those in APEC when discussion on political and security issues emerge. There is also a significant difference between the two transregional initiatives in the area of economic cooperation. According to Dent (1997: 31), while APEC aims to mutually align the regulatory environment of its member countries, ASEM's preferred objective is to establish congruency in selected administrative procedures, such as customs, standards and certifications. In addition, economic cooperation in ASEM aims to familiarize the economic actors with the policy regimes in both regions. At the same time, however, the proliferation of Eurasian and trans-Pacific cooperation carries the same positive and negative impacts on the multilateral trade system. On the positive side, both ASEM and APEC can act as catalysts to filter negotiations at the multilateral trade level. On the negative side, however, both transregional initiatives are capable of creating diversionary effects on trade and investment flows. Moreover, as with APEC, ASEM contains too many member countries whose interests differ greatly. Given such factors, ASEM's future is unclear.

Since ASEM's inception in 1996, there have been six biennial summits, which 'represent the apex of a host of activities held in the name of ASEM and are useful in charting the type of dialogue between the two partners' (Gilson, 2005: 314). The First ASEM Summit, which was held in Bangkok in February 1996, aimed to launch the organization and facilitate discussions among leaders of the participating

28 Further information about *The federal government concept of Asia* is available from the official Asien Haus website, <http://www.asienhaus.de/public/archiv/brdasia.htm>.

29 Further information about the New Trans-Atlantic Agenda is available from <http://www.eurunion.org/partner/agenda.htm>.

countries. This summit also gave birth to the Asia–Europe Foundation (ASEF) in Singapore in 1997, which aimed to foster greater people-to-people relations and to develop institutional links between the two regions (Kettunen, 2004: 143).[30] The EU also launched its own Asia Invest Programme shortly after the First ASEM Summit as a way of encouraging trade and investment between the EU and South and Southeast Asian countries. This programme assists European companies to study these new markets, evaluate potential business partners and identify investment opportunities. While many observers saw the First ASEM Summit as a step forward in Asia–Europe relations, problems started to emerge during the Second ASEM Summit, which took place in London in April 1998. The economic recession in Southeast Asia resulted in a modification of much of ASEM's original agenda. The Asian ASEM member countries simultaneously wanted discussion to centre on the immediate problems confronting their region. Although some tangible results did emerge, such as the Investment Promotion Action Plan and the ASEM Trust Fund, this summit also brought new elements into ASEM discussions. At the EU's insistence, contentious issues, such as democracy and human rights, were brought into the ring. The EU criticized the human rights violations in East Timor, which at the time was still an Indonesian province, and launched a similar attack on China for its lack of democracy.

The Third ASEM Summit was held in Seoul, South Korea, on 20–21 October 2000. As with the previous one, thus summit was overshadowed by another historic event, although this time of a more positive nature (Gilson, 2005: 315). Prior to the summit, South and North Korea had just finished their June 2000 summit, which acted as a gateway for further reconciliation between the two Koreas.[31] Although the issue of East Timor raised its head again, this summit also managed to discuss other issues, such as Kosovo, UN reform, the war on drugs, migration and the non-proliferation of weapons of mass destruction. On this occasion, ASEM member countries also discussed the issue of information technology and how communications could improve trade and investment flows between the two regions.[32] Copenhagen played host to the Fourth ASEM Summit in September 2002, where ASEM member countries agreed to focus their discussions around the fight against international terrorism. Accordingly, ASEM produced a separate statement called the Declaration on Cooperation against International Terrorism[33] as a response to the 9/11 terrorist attacks in the U.S. ASEM members also introduced a Dialogue on Cultures and Civilization,[34] while in the area of economics, members agreed to continue to support the WTO's DDA, particularly in relation to development,[35] by helping developing countries to engage with globalization processes, especially development sustainability. The EU raised the issue of the digital divide in a move to close the gap between the two regions with regard to information and communications technology.

The Fifth ASEM Summit, held in Hanoi on 8–9 October 2004, raised similar issues. This summit, however, also questioned the very nature of this transregional gathering. Apart from the 10 new EU member countries, the event was also attended by new ASEAN members, including Myanmar, Cambodia and Lao PDR. The event demonstrated how EU expansion now included its immediate

30 ASEF was established under the framework of the ASEM process. It seeks to promote mutual understanding, deeper engagement and ongoing collaboration among the people of Asia and Europe through greater intellectual, cultural and people-to-people exchanges between the two regions. Further information is available from the official ASEF website, <http://www.asef.org>.

31 The Third ASEM Summit also produced a separate declaration on the North–South Korea issue known as the Seoul Declaration for Peace on the Korean Peninsula.

32 For further information about the Third ASEM Summit, see European Commission (2000a).

33 Further details of ASEM's Declaration on Cooperation against International Terrorism are available on the official Japanese Ministry of Foreign Affairs website, <http://www.mofa.go.jp/policy/economy/asem/asem4/terro.html>

34 Further details of ASEM's Dialogue on Cultures and Civilization is available on the official Japanese Ministry of Foreign Affairs website, <http://www.mofa.go.jp/policy/economy/asem/asem5/culture.html>.

35 For further information about the Fourth ASEM Summit, see European Commission (2002a).

Eastern European neighbours, and also highlighted how ASEAN-10 was moving towards the creation of the ASEAN Community. At the time, this was scheduled to be established by 2020.[36] Finally, the most recent ASEM gathering was at its Seventh Summit, which was held in Beijing on October 2008. Apart from discussing community building and regionalization in East Asia, the ASEM member countries also agreed to provide constructive support to the emerging political situation in Myanmar. This summit also discussed other global issues, such the nuclear crises arising in Iran and North Korea. In the area of economics, ASEM member countries raised their concerns regarding the failure of the Sixth WTO Ministerial Conference, which was held in Hong Kong on December 2005, to achieve any substantial progress in concluding the current DDA negotiations. Consequently, ASEM member countries urged developed and developing countries to seek compromises so that negotiations could proceed further.[37]

In light of recent developments, the ASEM process, as with ASEAN–EU relations in general, remains bumpy. Most scholars agree that this process does not confirm the importance of transregionalism as a new layer of global governance, but argue instead that it acts mostly as an intermediary between bilateralism and multilateralism (Camroux, 2006: 33) or between regionalism and multilateralism. As with the trans-Pacific transregionalism initiative under the auspices of APEC, ASEM's informal nature and multidimensionality remain critical obstacles that prevent this forum from progressing beyond its current stage of development (Gilson, 2005: 323–24). These qualities are both a blessing and a curse. They are a blessing in that they provide space to a wide array of actors and allow the inclusion of wide ranging issues, such as international terrorism, as part of the discussion process. However, the sheer quantity of participants and the many issues that are included in the ASEM agenda are also a curse because they result in a lack of concentration on the areas of cooperation that the two regions would wish to develop further. The relevance of ASEM to ASEAN–EU cooperation can be evaluated in terms of the political and economic priorities of the participating countries (Kettunen, 2004: 144). While the EU recognizes the importance of broadening its relations with ASEAN plus Three (APT) in the ASEM framework, the forum also acts to reduce EU interest in Southeast Asia. This poses a new challenge for ASEAN, as it wishes to attract more attention from its European counterparts. However, the centrality of ASEAN in the APT process and beyond and the inclination of the plus Three countries to allow ASEAN to play a central role certainly give more leverage to ASEAN in the ASEM process.

Indonesia in the ASEAN–EU relationship

As one of ASEAN's founding fathers, Indonesia plays a significant role in the ASEAN–EU relationship. As the largest country in Southeast Asia in terms of population and geographical size, Indonesia has acquired leadership status among its peers in ASEAN. The centrality of Indonesia in ASEAN affairs is also reflected in the fact that the ASEAN Secretariat is located in Jakarta. Since the economic crisis in 1997, however, Indonesia's role as an ASEAN leader has begun to diminish. Today, the other four original member countries—Malaysia, Thailand, the Philippines and Singapore—play a relatively equal role to Indonesia. Despite this, Indonesia remains one of the most active players in ASEAN and the country's centrality in the association is well acknowledged by Brussels. Indonesia is also active in promoting regionalism beyond ASEAN. Apart from APEC, the country is involved in the ASEAN

36 For further information about the Fifth ASEM Summit, see European Commission (2002b).

37 For further information about the Sixth ASEM Summit, see Office of the Prime Minister of Finland (2006).

Regional Forum (ARF)[38] and ASEM, both of which the EU is a member. Throughout the New Order regime of President Suharto, there was little dialogue between Indonesia and the EC to promote common interests. The wave of political change in the aftermath of the 1997 economic crisis brought new cooperation between the two sides. Indonesia's new attitude towards democracy and human rights has certainly been welcomed by Brussels in recent years. Currently, alongside other major global powers, the EU sees Indonesia's stability as an important element in promoting peace, stability and democratic values in both Southeast Asia and the rest of Asia. Indonesia's strategic value has also increased in the eyes of many global powers, including the EU, since the 9/11 terrorist attacks in the U.S. in 2001. Indonesia is home to the largest Muslim population of any country in the world, and its relative democracy and degree of religious moderation is deemed important by the EU.

Indonesia has played an active role since the start of ASEAN–EC informal relations back in the early 1970s. Subsequently, the country was also involved in the first ministerial meeting between ASEAN and the EC in 1978, and was a signatory of the core document regarding the relationship between the two regional groupings: the 1980 ASEAN–EC Cooperation Agreement. Initially, the EC established the Delegation of the Commission of the European Communities (CEC) for South and Southeast Asia in Bangkok to oversee EC interests in the two subregions in 1979. Eight years later the Indonesian government approved the establishment of the CEC representation in Jakarta. Robert van der Meulen was later appointed as the first head of the CEC Representation to the RI, Singapore and Brunei Darussalam in 1989.[39] The CEC was later renamed the Representation of the European Commission to the RI, Singapore and Brunei Darussalam after the signing of the Maastricht Treaty in 1992.[40]

Deepening EU integration as a result of the 1992 Maastricht Treaty and the subsequent enlargement process that Europe underwent after the signing of the 1997 Treaty of Amsterdam brought major challenges for Indonesia (Ardie, 2004: 2). It had relied on major powers, including Western European countries, to provide developmental aid and was now concerned that the EU's attention in the field of development policy would shift to its newer members. Although the EU provides about 55 percent of total global official development assistance, much of this funding has been transferred to its newer members and the ACP countries. Indonesia was also concerned about the EU's increased bargaining position as a result of the introduction of the latter's single market programme and the enlargement process. These new measures increased Indonesia's concern over, for example, how its agricultural commodities could access the EU. At the multilateral trade level, it was expected that EU enlargement would encroach on Indonesian interests in the WTO. Thirdly, it was expected that EU growth would have a trade diversion impact on Indonesia. Apart from the elimination of tariffs, the EU's single market programme also entailed the movement of people, which was expected to provide more advantages to EU than non-EU business.

38 Established in Bangkok on 25 July 1994, the ARF serves as a regional security forum for its member countries. The objective of this forum is twofold: (1) to foster constructive dialogue and consultation on political and security issues of common interest and concern; and (2) to make significant contributions to confidence building and preventive diplomacy in the Asia-Pacific region. The ARF currently has the following members: ASEAN, the EU, Australia, Bangladesh, Canada, China, India, Japan, North Korea, South Korea, Mongolia, New Zealand, Pakistan, Papua New Guinea, the Russian Federation, Timor Leste and the U.S. For further information, see the official ARF website, <http://www.aseanregionalforum.org>.

39 Between 1980 and 1985, however, the permanent residence of the head of the CEC Delegation to Indonesia was located in Bangkok. By the end of 1985 the CEC office was moved to Jakarta under the leadership of Rüdiger Wenk.

40 From May 2000 onwards the Representation of the European Commission was renamed the Delegation of the European Commission.

Indonesia's immediate reaction towards EU growth was to launch the ASEAN FTA in 1992, while attempting to engage constructively with the EU. The New Order regime had rejected Singapore's idea to create a common market in 1986, arguing that the ASEAN region was not yet able to cope with greater integration. The move towards regionalism in the early 1990s in both Western Europe and North America made Indonesian policymakers view regional integration more favourably, however. Indonesia, alongside other members of ASEAN, had three options with regard to the growth of regionalism in Europe and North America. The first was for each individual country to support the GATT system and the completion of the Uruguay Round. The second was to enhance REI, while the third option was to initiate economic cooperation with North American and European integration mechanisms. Over time, it became clear that the second and third options were more feasible for ASEAN, since member countries had desired greater economic cooperation in the region, and had been unable to put policies into place in the past for political reasons.

The 1997 economic crisis also challenged the relationship between Jakarta and Brussels, with the wave of political transformation as a result of the crisis providing greater scope to the relationship. Contentious issues, such as democracy, good governance and human rights, which the EU had found difficult to discuss with the New Order regime, were now embraced as important elements in Indonesia–EU relations. Prior to the visit of the Indonesian president, Abdurrahman Wahid, on February 2000, the European Commission (2000b) released a communication to the European Council and the European Parliament entitled 'Developing closer relations between Indonesia and the European Union'. This document identified some of the areas that the EU wished to explore in order to assist Indonesia with the growth of democracy, with particular emphasis in areas such as politics, society, economics, development and the environment. This document also paid specific attention to the issue of human rights, which the EU still believed to be the main prerequisite for both a democratic society and sustainable development. After the first political dialogue between the EU and the Indonesian government took place later that year, the EU adopted the 2002–06 Country Strategy Paper (CSP) (European Commission, 2002c). This document highlighted the EU's willingness to improve relations with Indonesia, and introduced a sector focused programme aimed at making EU support in Indonesia more visible and more effective (Mission of Indonesia to the European Communities, n.d.). The drafting of the CSP also took into account the priorities of the Indonesian government, such as good governance and the rule of law, better decentralization and power distribution to provincial governments, poverty alleviation, employment creation, and the reduction of social unrest. Indonesia was later granted EUR 216 million to implement this CSP.

Development and humanitarian aid have also become increasingly prominent issues in the relationship between Indonesia and the EU in recent years. Although the EU is currently Indonesia's second largest trading partner, EU aid has contributed less than 10 percent of Indonesia's total bilateral aid (Cook, 2004). Under the aforementioned 2002–06 CSP, EU aid to Indonesia went up to EUR 216 million, an increase from the total of EUR 300 million that had been paid out over the previous 25 years. The EU also provided assistance to Indonesia when the Asian tsunami hit war-torn Aceh at the end of 2005. About 130,000 out of the total of 200,000 people who died as a result of the tsunami were Acehnese, while another 500,000 Acehnese lost their homes (European Parliament, 2007). The EU provided a post-tsunami aid package worth EUR 207 million to the Indonesian government. In total, around EUR 440 million was pledged by 15 countries and organizations for the reconstruction of Aceh and its surrounding areas, and 85 percent of this funding came from EU member countries. The EU also allocated EUR 10 million in humanitarian aid to Indonesia following the earthquake in Jogjakarta in May 2006. The European Commission later provided another EUR 40 million towards reconstruction programmes in Jogjakarta.

The relationship between Indonesia and the EU has not always been easy. During the New Order regime, Jakarta fell short of EU expectations with regard to its record on human rights and democracy. The mass killing of unarmed demonstrators by Indonesian security forces in the East Timorese capital of Dili in 1991 resulted in great tension between Jakarta and Brussels. Portugal, the former colonial master of East Timor and a member of the EC, accused the Suharto regime of committing gross violations of human rights, which led to the EC imposing an embargo on Indonesia. The East Timor issue remained an area of contention between the two sides even after the fall of the New Order regime in 1998. The EU took a very pro-East Timorese stance against the Indonesian government after an outbreak of violence occurred following the East Timorese general election on 30 August 1999. The EU imposed another embargo on Indonesia, which was lifted when the two sides reached an agreement that Jakarta would seek peaceful resolutions to other ethnonationalist movements in Indonesia (Reuter, 1999). Since East Timor won its independence, the EU has demonstrated its commitment to a united, democratic, stable Indonesia (EU Council Secretariat, 2006) by engaging constructively in the promotion of peaceful resolutions between the Indonesian government and other secessionist movements in the country, such as the Aceh Freedom Movement (Gerakan Aceh Merdeka).

A more recent conflict between Indonesia and the EU took place in June 2007 when the EU banned all Indonesian airlines from flying within its territory. This was in spite of the fact no Indonesian airlines were flying to Europe at that time. Garuda Indonesia, the state owned airline company, was the only Indonesian airline that had previously had some operations in Europe, but was forced to suspend its European services as a result of a series of financial difficulties. Although the EU finally lifted the ban on July 2009, an anonymous source from the RI Embassy in Brussels once hinted that the Indonesian government would retaliate against the EU's unilateral action against Indonesian interests.[41] As with other countries in ASEAN, the EU is currently negotiating a Partnership and Cooperation Agreement (PCA), which is a treaty of cooperation between the EU and its external partners that includes provisions on political, trade, social, cultural and security links with Indonesia. Under this type of agreement, the EU normally expects its partners to carry out political, economic or human rights reforms in exchange for free market access to the EU. This PCA should also serve as an umbrella agreement between the EU and Indonesia. However, given Indonesia's growing need to seal a bilateral free trade and investment deal with the EU in the near future, it is unlikely that Jakarta will stall PCA negotiations vis-à-vis Brussels. Even if Jakarta decides to do so, it is likely to be temporary in nature.

With regard to the latest EU CSP for Indonesia (2007–13), the EU intends to focus on poverty reduction, and the promotion of economic growth and good governance (European Commission, 2007a). A total of EUR 494 million has been allocated to support these objectives. While good governance will be promoted through assistance given to improve law enforcement in Indonesia, poverty alleviation and economic growth will be encouraged through trade and investment initiatives. The EU wants to help improve Indonesia's economic performance through an outward looking strategy based on increased trade and investment. The current CSP also includes points that were omitted from the 2002–06 CSP, particularly with regard to the specific barriers to EU–Indonesia trade flows, such as standardization and quality control mechanisms. Such barriers impact on Indonesian companies that are exporting to the EU. The current CSP also highlights the importance of the ongoing AEUFTA trade and investment dialogue under the TREATI as a key element in making the EU Indonesia's main economic partner.

41 Informal telephone discussion with an anonymous member of staff at the RI Embassy in Brussels, 20 August 2007.

A BFTA as a means to enhance the ASEAN–EU partnership?

The move towards the AEUFTA

For policymakers in both ASEAN and the EU, a BFTA is expected to enhance the partnership between the two regions. The initial request to start AEUFTA negotiations came from the ASEAN side. Concerned about the potential collapse of global trade talks under the WTO's DDA, ASEAN member countries had established a web of BFTAs with trade partners. While ASEAN and its member countries have managed to secure FTAs and/or EPAs with some major trade partners, such Japan, the U.S., China, etc., they had been unable to establish such trade or economic arrangements with the EU. The economic union of EU member countries has proved successful in increasing the bloc's stature in international economic diplomacy. At the same time, concerns have also been raised by many ASEAN policymakers and economic actors over the EU's persistently protectionist approach. Such factors motivated ASEAN to make the initial move to establish an AEUFTA with the EU. A stronger economic partnership with the EU is expected not only to bring prestige, but also economic benefits to ASEAN.

The EU responded positively to ASEAN's request to discuss a possible AEUFTA. At the third meeting between ASEAN economic ministers and the EU, which was held in Luang Prabang on 4 April 2003, the EU agreed to launch the TREATI. In July 2003 a document entitled 'A new partnership with South East Asia' was drawn up in this regard. In this communication, the European Commission proposes an action plan to 'expand trade and investment flows and establish an effective framework for dialogue and regulatory co-operation on trade facilitation, market access, and investment issues between the two regions' (European Commission, 2003a: 16). In essence, TREATI is a region-to-region economic cooperation initiative consisting of dialogue and joint activities in areas of mutual economic interests to ASEAN and the EU.[42] TREATI is a reflection of the growing importance of the Southeast Asian region as a trading partner for the EU. A year prior to the launching of TREATI, in the first quarter of 2002, bilateral trade between ASEAN and the EU reached USD 64.4 billion, making the EU ASEAN's third largest trade partner. TREATI reflects the realization of EU member countries that they have been somehow left out of the recent FTAs between ASEAN, China, Japan and the U.S. (Singapore Mission to the European Communities and the Embassy to the Benelux, 2003). The DDA world trade negotiations are also high on the EU's agenda, and the EU hopes to establish a partnership with ASEAN in order to achieve a mutually satisfactory and successful conclusion to these negotiations. Apart from these motives, the EU's interest in launching a new initiative with ASEAN is also due to the latter's commitment to regionalism and to establishing the ASEAN Community by 2015. For the EU, therefore, a *deeper FTA* is seen as the logical step to extend its developing partnership with ASEAN.

Shortly after the TREATI was launched, the ASEAN–EU Vision Group, composed mainly of experts from the two regions, was set up to look into the possibility of greater economic partnership between the two sides. The Vision Group issued a report in 2006 entitled *Transregional partnership for shared and sustainable prosperity*, which makes recommendations with regard to any future ASEAN–EU economic partnership. The Vision Group concluded that there is a compelling argument in favour of

42 TREATI is implemented primarily on a region-to-region basis, because the EU considers this a more efficient way to deal with a number of economic issues that are common to many ASEAN members. Both ASEAN and the EU also prefer this method because it can encourage greater sharing between the two blocs. It also helps to maximize the use of resources and achieve economies of scale as much as possible for both sides.

taking the economic partnership to a higher level. It also suggested that this enhanced economic partnership should be based on two key recommendations. The first is compliance with WTO rules and regulations: the AEUFTA should be as comprehensive as possible, covering all areas of liberalization proposed by the WTO. The second is that existing ASEAN–EU economic cooperation should be expanded. Such initiatives should not simply supplement or go beyond the areas agreed under the TREATI, but should also seek to assist the least developed nations of ASEAN in coping with the challenging outcomes that liberalization leads to. In preparation for the Thirty Years Commemorative Summit between ASEAN and the EU, the Sixteenth AEMM was held in Nuremberg on 14–15 March 2007. Ministers from both regions issued the Nuremberg Declaration, which reiterated many elements of the European Commission's 2003 communication and the subsequent 2006 Vision Group recommendations.[43]

In 2007 the European Council authorized the European Commission, the executive body of the EU, to start free trade negotiations with ASEAN,[44] as well as with South Korea and India (European Commission, 2007b). Apart from highlighting the background to relations between ASEAN and the EU, the draft mandate also specifies the nature and scope of the proposed AEUFTA. This directive also instructed the European Commission to negotiate a comprehensive FTA that aims to improve market access for goods and services, and that includes binding provisions on regulatory transparency in trade and investment related areas. The European Council requested that the European Commission conduct FTA negotiations with ASEAN, in line with the EU's *Global Europe strategy*, which was formulated on 4 October 2006.[45] The EU and ASEAN are keen to use a BFTA as a means to enhance their partnership. However, as we shall see in the following chapters, the likely outcome of an AEUFTA might not be as rosy as the outcome predicted by policymakers and mainstream scholars in the regions concerned.

The case for and against the AEUFTA

Prior to presenting the case for and against the AEUFTA, it is perhaps useful to ask whether this trade agreement is necessary. Apart from their commercial objectives, BFTAs are set up in order to advance the political objectives of participating countries, and the AEUFTA is no exception. As noted earlier, it was ASEAN's idea first. For ASEAN member countries, an AEUFTA does not only offer wider market access to the EU market, but is also expected to raise ASEAN's profile in international political economy diplomacy. The EU's increasingly influential role in the global economy is one significant reason why ASEAN has decided to establish an AEUFTA. As a relatively weak political entity in the global political economy, ASEAN policymakers see access to Brussels' political and economic agenda as very important. On the political front, an AEUFTA should serve as a starting point for ASEAN to try to draw EU attention to the Southeast Asian region. The AEUFTA is also seen as a counterbalance to the increasingly aggressive economic agenda of the U.S. and China in the Southeast Asian region. The vulnerability of ASEAN economies has made it necessary for the association to engage with major global economic powers. So far, however, it is only with the EU that ASEAN has failed to set up an FTA initiative.

As far as the EU is concerned, there are at least three main reasons for setting up an AEUFTA. Firstly, it will serve the EU's commercial objectives. Apart from neutralizing any potential trade diversion that could result from enhanced economic integration in the EU region, an AEUFTA would also allow the

43 For further details of the Nuremberg Declaration, see ASEAN Secretariat (2007a).

44 Further information about the European Commission's mandate to start FTA negotiations with ASEAN is available in Appendix 2.

45 For further information about the EU's Global Europe strategy, see European Commission (2006a).

EU to forge strategic links with the rapidly growing economies of ASEAN (Woolcock, 2007). In addition, like many other developed countries, the EU is interested in enforcing international trading rules by means of an AEUFTA, especially at a time when WTO global trade talks are stalling. Secondly, the economic growth and development in the ASEAN region that will result from the AEUFTA are expected to bring about political transformation in some of the most oppressive regimes in Southeast Asia, particularly Myanmar. Finally, the EU wants to promote the European model of integration in the Southeast Asian region. The AEUFTA should complement the EU's existing ASEAN Programme for Regional Integration Support (APRIS), which seeks to develop a strategic approach to the deepening regional integration in Southeast Asia.[46] The AEUFTA is expected to act as an external pressure for ASEAN to work collectively as a bloc.

So, what are the benefits and costs accruing from the AEUFTA for both ASEAN and the EU? To date, the majority of existing cost benefit analysis on the AEUFTA has been produced by mainstream intellectuals and academic think tanks, most of whom favour neoliberal trade and investment liberalization. The European Commission's quantitative study of an AEUFTA, which was carried out by CEPII-CIREM (2006), for instance, suggests that an AEUFTA would generate significant economic benefits for both ASEAN and the EU. The CEPII-CIREM study proposes three different scenarios for the AEUFTA: (1) tariffs on goods are fully dismantled, while 50 percent of barriers in the services sectors are removed; (2) a list of sensitive products is excluded in the agreement; and (3) an alternative pre-experiment scenario is used whereby two other FTAs are assumed to take place at the same time as the AEUFTA (the first between ASEAN and all other industrialized countries, except the EU-25, and the other between the EU-25 and Mercosur). The CEPII-CIREM study found that: (1) the gains accruing to ASEAN member countries are potentially significantly large, totalling more than 2 percent of gross domestic product (GDP) by 2020; (2) three quarters of the potential gains accrued by ASEAN are associated with benefits generated by service sector liberalization; (3) ASEAN and the EU would gain if a list of sensitive products were included in the agreement; and (4) the agreement would be more desirable if the EU formed a BFTA with Mercosur, and ASEAN fully implemented BFTAs with Japan and the U.S. At the macro level, the CEPII-CIREM study also argues that the AEUFTA should increase EU exports to ASEAN by 24.2 percent and increase ASEAN exports to the EU by 18.5 percent.

Earlier in 2007, the Directorate General for Trade of the European Commission (DGTEC) issued a memo highlighting the main findings of the EU's feasibility studies on the AEUFTA, the EU–India FTA and the South Korea–EU FTA. These studies suggest the following:

(1) The three agreements should boost EU exports to ASEAN by 24.2 percent, to India by 56.8 percent and to South Korea by 47.8 percent. They should also increase total EU exports by 3.23 percent and increase the EU's GDP by 0.13 percent.

(2) They should raise ASEAN exports to the EU by 18.5 percent, Indian exports to the EU by 18.7 percent and South Korean exports to the EU by 36 percent.

(3) They could add a 40 percent benefit to the EU as part of the benefits generated by the successful conclusion of the Doha Round negotiations.

46 Further details of the APRIS are available on the official ASEAN Secretariat website, <http://www.aseansec.org/apris/index.asp>.

With regard to the AEUFTA, this memo also adds that the largest gains for the EU can be found in business services, where there will be an increase of 29 percent (worth EUR 7.9 billion), while the corresponding business sector should increase by about 80 percent (worth EUR 14 billion).

Many other critical studies on the AEUFTA and on EU-led BFTAs and/or EPAs present a different argument, however. Prof. Alfredo Robles (2007) of De La Salle University in the Philippines, for example, discusses 'the false promises of an ASEAN–EU FTA'. Some areas Robles identifies as needing clarification are: (1) the question of who is to be accountable if the estimates of the European Commission turn out to be inaccurate; (2) the question of who is to compensate ASEAN countries if some of them still experience trade deficits vis-à-vis the EU; (3) whether the AEUFTA is to be suspended or annulled if ASEAN's trade balance fails to improve; (4) whether all the unemployed in the industrial sector would be able to find new jobs in the service sector; and (5) the estimated loss in tariff revenues associated with the establishment of an FTA. Previous studies, such as the study conducted by Bilal and Rampa (2006), also question the estimations made in the European Commission's feasibility studies. Quantitative impact studies are difficult to back up because of methodological constraints and the limited availability of data about developed and developing countries. In their analysis of the European Commission's assessment of the EPA between the EU and the ACP countries, for instance, Bilal and Rampa (2006: 35) observe that the production sector has been totally ignored. This is because such information about ACP countries is not available. The same is also true of Southeast Asian countries. In their analysis of the economic impacts of the ASEAN–China FTA on the Indonesian economy, Pambudi and Chandra (2006: 34) observe that the lack of trade and economic data often leads ASEAN policymakers to make uninformed decisions. BFTA assessments should, therefore, take into account qualitative investigations of specific economic sectors.

Concluding remarks

This chapter has analyzed the evolution of the relationship between ASEAN and the EU, and Indonesia and the EU. From the first informal dialogue between ASEAN and the EU, relations have evolved from mere bilateral interregionalism into a more complex transregional initiative in the form of ASEM. Despite their long standing relationship, much remains to be done to foster greater cooperation and partnership between the two regional blocs. The lack of political will and poor institutional support has meant that there is little incentive for the ASEAN–EU dialogue to grow during the first phase of the relationship. The end of the Cold War gave fresh incentive for ASEAN and the EU to improve their relationship. The expansion of ASEAN–EU dialogue in the form of ASEM in the mid-1990s gave new weight to trans-Eurasia relations. Nevertheless, the clash of principles over issues such as democracy and human rights remained key obstacles to fostering greater cooperation between ASEAN and the EU.

ASEAN's recent promotion of regionalism in Southeast Asia and beyond and its increasingly prominent role in international economic diplomacy, including the formation of BFTAs with key global economic players, have provided the EU with motives for engaging more closely with ASEAN. The possible AEUFTA will be a test case for both regional groupings. Policymakers from both sides are convinced that the agreement will be economically beneficial; but both sides could be wrong. The fact that the two sides have divergent economic interests is likely to affect the AEUFTA negotiations. This is not to mention the sensitivity of certain issues for some ASEAN member countries, such as human rights and democracy. It is also beyond any doubt that the AEUFTA implementation process will generate significant adjustment costs for many ASEAN member countries. At best, therefore, rather than being of real economic benefit, the AEUFTA is likely to raise the political profile of ASEAN in Brussels. However, even this is dependent on ASEAN's ability to compete with other regional organizations and/or countries that are also keen to form economic alliances with the EU.

Chapter 3 – Trade Regimes and Policymaking in ASEAN and the EU

Introduction

Trade and investment expansion has been a driving force behind the proposed AEUFTA. The prospect of market access to the EU and attracting more foreign direct investment (FDI) to and from the EU have been ASEAN's primary motives for adopting this trade strategy. Although the EU already has a relatively strong economic presence in ASEAN, European policymakers and businesses expect that an AEUFTA will open up new areas in trade and investment relations between the two regions. Mainstream economists might be optimistic about the AEUFTA's potential benefits, but the adjustment costs associated with implementing this trade agreement will prove costly for ASEAN, however. Over the years the structure and volume of trade and investment relations between ASEAN and the EU have evolved considerably (Kettunen, 2004: 148), yet trade relations between the two regional groupings remain asymmetrical. Traditionally, ASEAN traded products from its tropical primary sectors in exchange for Europe's manufactured products. Although the industrialization of Southeast Asian economies has led to greater diversity among ASEAN's exports to the EU in recent years (Hill and Athukorala, 1998; Bende-Nabende, 2000; Alvstam, 2001), the EU maintains a protectionist policy on the sectors that ASEAN countries have interests in. Apart from the fact that EU subsidies hamper ASEAN's agricultural exports to Europe, ASEAN member countries are also the main targets for some of the EU's contingent protection measures, such as anti-dumping duties or countervailing measures (Consortium of Euro-Asia Centre and IFRI, 2006: 58). Trade relations between ASEAN and the EU might be generally favourable to ASEAN, but the majority of ASEAN exports come from Singapore. With regard to foreign investment, there is more EU investment in Southeast Asia than Southeast Asian investment in Europe. Although it is perhaps too soon to say that the proposed AEUFTA negotiations will be dominated by the EU, Europe certainly has more resources at its disposal to ensure that its interests stay at the top of the trade deal negotiations agenda. There is asymmetry not only in relations between ASEAN and the EU, but also in their trade and investment policymaking processes. The free trade agendas of both ASEAN and the EU are driven mainly by large corporate interests. Given such asymmetry, it is questionable whether an AEUFTA is the best way to enhance ASEAN–EU relations.

The objectives of this chapter are twofold: (1) to identify the key characteristics of the existing trade and investment policies in both ASEAN (including Indonesia) and the EU; and (2) to analyze the trade and investment policymaking processes in the two groupings. The discussion is organized into several sections. The next section examines the patterns in trade and investment relations between ASEAN and the EU, which should reveal the emerging trends in the relationship between the two regional groupings. The third and fourth sections then analyze the existing trade and investment policy regimes and the policymaking processes in both ASEAN and the EU.

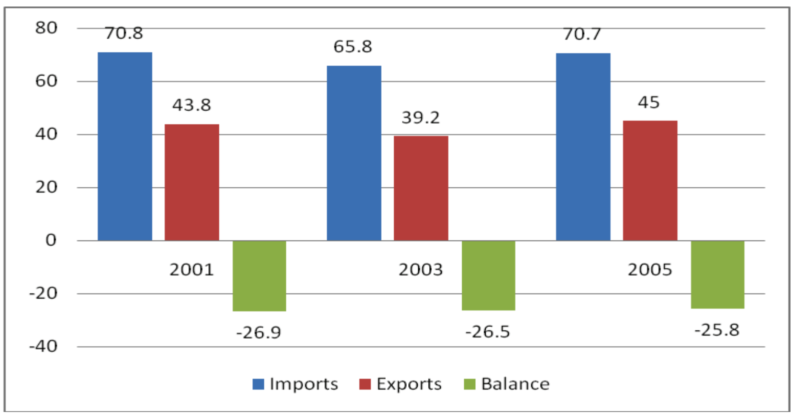
Patterns in ASEAN–EU trade and investment

The value of trade between ASEAN and the EU has increased significantly since relations between the two regional groupings were formalized through the ASEAN–EC Cooperation Agreement in 1980 (Kettunen, 2004: 149). Between 1980 and 1985 exports from the then EC to ASEAN rose by 84.4 percent from EUR 5.32 billion to EUR 9.81 billion, while ASEAN's exports to the EC rose by 44.7 percent from EUR 6.89 billion to EUR 9.97 billion (Dent, 1997: 51).[47] During this period, the bulk of

47 Although the euro did not exist at this point in time, it is common for analysts to give euro monetary values when discussing the pre-euro period. The EUR : USD exchange rate used to give an equivalent dollar value is EUR 1 = USD 1.2.

ASEAN's exports to the EC consisted of tropical primary commodities. The ASEAN Secretariat (2002) reported that agricultural products accounted for about 48 percent of ASEAN's exports to the EC. This is a significant contrast to the figure of 36 percent for manufactured products exported by ASEAN to the EC in the same period. The trend, however, changed in the 1990s as many ASEAN countries began to industrialize. During the 1990s, ASEAN's exports of manufactured goods rose by about 80 percent, while agricultural exports decreased by 16 percent. ASEAN's exports to the EU took off after 1987, reaching USD 58 billion in 2000. Prior to 1987, however, ASEAN's exports to the EU were worth between USD 5 million and USD 10 million per annum. Similarly, EU exports to the ASEAN economies also rose significantly between 1980 and 1997, peaking in 1996 when the value of EU exports to ASEAN reached USD 58 billion. Since the economic crisis of 1997, EU exports to ASEAN have decreased, reaching a low point in 1999 when they were worth only about USD 31 billion. The decrease in the total value of EU exports to ASEAN during the immediate post-crisis period was mainly due to the depreciation of some ASEAN currencies, particularly Indonesia's.

Figure 3.1: EU-25 merchandise trade with ASEAN, 2001–05 (EUR billion)



Source: DGTEC (2006a: 1)

Table 3.1: EU-25 imports and exports from and to ASEAN by SITC* section, 2005

EU imports from ASEAN				EU exports to ASEAN			
Products (SITC sections) by order of importance	Value (EUR million)	%**	Share of total EU imports	Products (SITC sections) by order of importance	Value (EUR million)	%**	Share of total EU exports
Machinery and transport equipment	34,653	48.9	9.2	Machinery and transport equipment	24,728	55.0	5.2
Misc. manufactured articles	13,834	19.5	8.3	Chemicals and related products	6,248	13.9	3.8
Chemicals and related products	6,450	9.1	6.9	Manufactured goods (materials)	4,667	10.4	3.5
Manufactured goods (materials)	4,215	6.0	3.6	Misc. manufactured articles	3,508	7.8	2.9
Food and live animals	3,598	5.1	6.6	Food and live animals	1,371	3.0	3.9
Crude materials inedible, except fuels	2,831	4.0	6.2	Commodities and transactions	1,038	2.3	3.6
Animal and vegetable oils, fats and waxes	1,966	2.8	48.0	Crude materials inedible, except fuels	702	1.6	3.6
Mineral fuels, lubricants and related materials	1,492	2.1	0.6	Beverages and tobacco	649	1.4	4.0

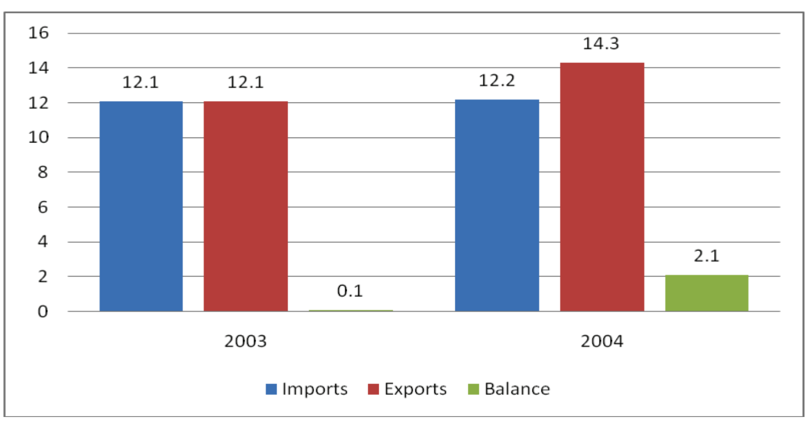
EU imports from ASEAN				EU exports to ASEAN			
Products (SITC sections) by order of importance	Value (EUR million)	%**	Share of total EU imports	Products (SITC sections) by order of importance	Value (EUR million)	%**	Share of total EU exports
Commodities and transactions	309	0.4	1.2	Mineral fuels, lubricants and related materials	618	1.4	1.6
Beverages and tobacco	139	0.2	2.9	Animal and vegetable oils, fats and waxes	46	0.1	1.9
Total imports	70,809	100.0	6.0	Total exports	44,966	100.0	4.2

* SITC = Standard International Trade Classification.
** These columns do not total exactly 100 due to rounding.

Source: DGTEC (2006a: 5)

Trade between ASEAN and the EU started to pick up again in the new millennium. From 2001 to 2005, ASEAN exports to the EU were worth between EUR 65 billion and EUR 70.8 billion, while ASEAN imports from the EU within the same period were worth between EUR 39 billion and EUR 44 billion (refer to Figure 3.1). These figures peaked in 2005, when ASEAN exports to the EU were worth EUR 70.8 billion and ASEAN imports from the EU were worth EUR 44.9 billion, creating a trade surplus of EUR 25.8 billion in ASEAN's favour. During this time, ASEAN managed to maintain a trade surplus of around EUR 26 billion in merchandise trade vis-à-vis the EU. In 2005 the EU was experiencing trade deficits in its trade relations with ASEAN, apart from in the non-agricultural raw materials and iron and steel sectors. ASEAN's major exports to and imports from the EU were machinery and transportation equipment, taking up 48.9 percent and 55 percent, respectively, of the total ASEAN–EU merchandise trade in 2005 (refer to Table 3.1). In the same year, ASEAN sold more agricultural commodities to the EU than the other way around. ASEAN, however, has been experiencing trade deficits of about EUR 2.1 billion in the trade in services sector (refer to Figure 3.2). Despite the relatively equality in trade in services between ASEAN and the EU, Singapore provides the majority of ASEAN's service exports to the EU. In 2005 ASEAN ranked as the EU's sixth major trading partner, while the EU was ASEAN's third major trading partner after the U.S. and Japan (refer to Table 3.2).

Figure 3.2: EU-25 trade in services with ASEAN, 2003–04 (EUR billion)



Source: DGTEC (2006a: 1)

In the area of investment, the EU's FDI has been more profitable in the Far East than in any other region (European Commission and Eurostat, 2007: 73). Although 41 percent of this investment is in Northeast Asian countries such as China and Hong Kong, about 31 percent of the EU's total FDI in the region now goes to ASEAN member countries. During the early years of ASEAN–EU relations, the cumulative stock of FDI from EC firms rose by 83.5 percent from USD 4,183 million to USD 7,675 million. Consequently, the EC's share in ASEAN's total inward FDI rose from 18.7 percent in 1980 to 21.7 percent in 1985. From then on, the EC was able to maintain its position as one of ASEAN's main foreign investors. ASEAN has based its economic development on FDI. Although foreign investments have continued to flow at respectable levels for most ASEAN countries, the 1997 economic crisis contributed to a significant drop in foreign investment in the region (Siew-Yean, 2005: 154). ASEAN's share in world FDI, for instance, dropped from an annual average of 7.5 percent between 1990 and 1995 to 6.3 percent after the 1997 crisis. ASEAN's share in world FDI fell further in 2000 to 0.8 percent, although it then improved to 1.6 percent and 2.1 in 2001 and 2002, respectively.

Table 3.2: ASEAN's and the EU's major trading partners, 2005

	ASEAN			EU		
Rank	Partners	Value (EUR million)	%	Partners	Value (EUR million)	%
1	U.S.	125,062	12.9	U.S.	414,714	18.5
2	Japan	121,395	12.5	China	209,894	9.4
3	EU	117,004	12.1	Russian Fed.	163,211	7.3
4	China	96,803	10.0	Switzerland	148,334	6.6
5	Singapore	82,741	8.5	Japan	116,906	5.2
6	Malaysia	67,636	7.0	Norway	101,261	4.5
7	South Korea	42,145	4.4	Turkey	75,341	3.4
8	Hong Kong	42,040	4.3	South Korea	53,456	2.4
9	Indonesia	39,621	4.1	Canada	40,855	1.8
10	Thailand	37,188	3.8	India	40,021	1.8
(6)				ASEAN (total)	115,755	5.2

Source: DGTEC (2006a: 3)

In spite of the 1997 economic crisis, the EU-25 countries continued to be the top foreign investors in the Southeast Asian region. This trend continued in the post-economic crisis period. Between 2000 and 2006, for instance, the EU-25 ranked as the highest source of FDI inflow to ASEAN, accounting for USD 44,955.6 million, or about 26.3 percent of ASEAN's total FDI (refer to Table 3.3). The majority of EU investments in ASEAN during this period went to the ASEAN-5 countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand). Among the ASEAN-5, however, Singapore absorbed the majority of FDI inflows from the EU. Between 1995 and 2004, Singapore absorbed around USD 39,588 million worth of EU investment. Other major recipients of EU FDI during the same period were Malaysia, Brunei Darussalam and Indonesia, receiving around USD 9,428 million, USD 6,416 million and USD 3,776 million, respectively. Prior to the enlargement of the EU in 2004, 84 percent of the EU-15's total foreign investment went to the ASEAN-5 countries, while the remaining 16 percent went to the newer ASEAN members (including Brunei Darussalam).

The pattern of trade and investment for Indonesia and the EU has been similar to the pattern of ASEAN–EU trade and investment in general. For the EU, trade relations with Indonesia have been more important than with other Southeast Asian countries. Prior to the 1997 economic crisis, the trade balance between Indonesia and the EU slightly favoured the EU. Between 1981 and 1999 total exports from Indonesia to the EU were worth USD 72,484.4 million, while imports from the EU amounted to USD 76,334.8 million (refer to Figure 3.3). For the first five years after the formalization of ASEAN–EU relations, trade between Indonesia and the EU was relatively constant, with Indonesian exports to the EU averaging about USD 1,012.4 million, while its average imports from the EU were worth USD 1,202.32 million. Exports from Indonesia to the EU and imports from the EU to Indonesia began to surge in 1986. Since then, EU exports to Indonesia have exceeded imports from that country.

Table 3.3: Top 10 sources of ASEAN FDI inflows, as of 13 August 2007

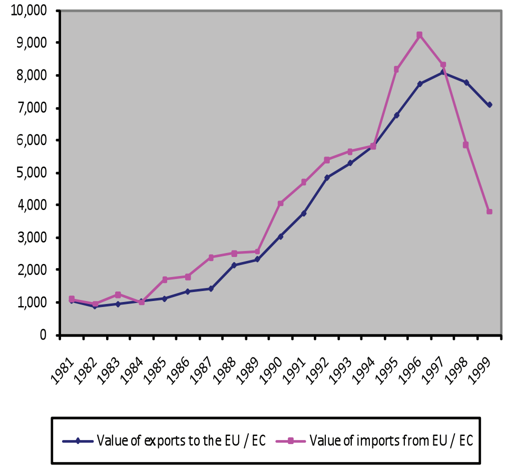
Country*	Value (USD million)				Share in total inflow (%)			
	2004	2005	2006	2002–06	2004	2005	2006	2002–05
EU-25	10,046.1	11,139.6	13,361.9	44,955.6	28.6	27.1	25.5	26.3
Japan	5,732.1	7,234.8	10,803.3	30,813.7	16.3	17.6	20.6	18.0
ASEAN	2,803.7	3,765.1	6,242.1	19,377.7	8.0	9.2	11.9	11.3
U.S.	5,232.4	3,010.6	3,864.9	13,736.1	14.9	7.3	7.4	8.0
Central and South America**	(60.5)	919.4	1,035.1	3,958.3	(0.2)	2.2	2.0	2.3
Hong Kong	529.6	773.0	1,353.4	3,430.7	1.5	1.9	2.6	2.0
South Korea	806.4	577.7	1,099.1	3,347.3	2.3	1.4	2.1	2.0
Cayman Islands	2,029.1	(19.9)	476.4	3,003.7	5.8	(0.0)	0.9	1.8
Taiwan (province of Taiwan)	366.8	(66.8)	668.1	2,417.4	1.0	(0.2)	1.3	1.4
China	731.5	502.1	936.9	2,302.9	2.1	1.2	1.8	1.3
Total top 10 sources	28,217.1	27,835.4	39,841.2	127,343.3	80.4	67.8	76.1	74.5
Others***	6,900	13,232.4	12,538.3	43,378.5	19.6	32.2	23.9	25.5
Total	35,117.2	41,067.8	52,379.5	170,821.9	100.0	100.0	100.0	100.0

Notes:
* Identified based on cumulative FDI inflow, 2001–05.
** Includes countries in Central and South America other than Argentina, Brazil, Mexico and Panama.
*** Includes inflow from all countries, as well as total reinvested earnings in the Philippines (local banks only) for 2001–05 and intercompany loans in Singapore for 2005.

Source: ASEAN Secretariat (2007b)

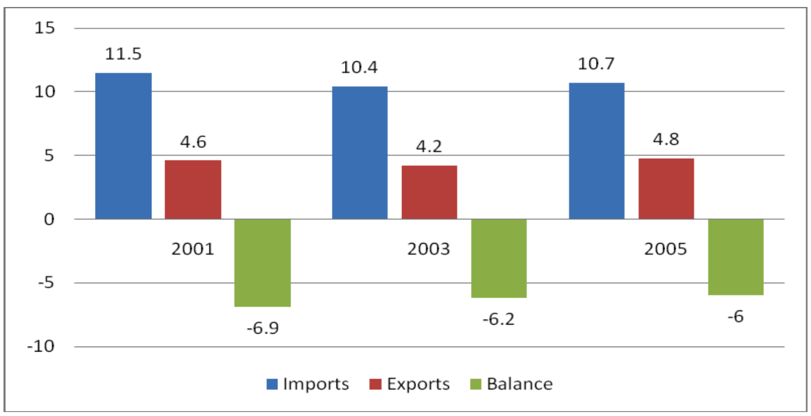
In the post-1997 crisis period, however, Indonesia recorded a trade surplus of nearly EUR 6 billion per annum. Indonesia's merchandise exports to the EU decreased slightly from EUR 11.5 billion in 2001 to EUR 10.7 billion in 2005 (refer to Figure 3.4). Despite this, trade relations between them are constant, with about EUR 15.5 billion worth of products exchanged each year since 2000 (Delegation of the European Commission, n.d.). Indonesia's major exports to the EU are agricultural products, and textiles and clothing, while the EU's major exports are machinery, transport equipment and chemicals. In 2005 alone Indonesia's trade surplus with the EU on agricultural products, and textiles and clothing reached EUR 1.9 billion and EUR 1.4 billion, respectively. In the last few years the trade in services between Indonesia and the EU has been relatively balanced. In 2003 the trade in this sector favoured Indonesia, while in 2004 the trade balance favoured the EU (refer to Figure 3.5). In general, Indonesia accounts for about 0.3 percent of the EU's total trade in services (the U.S. and Switzerland take the largest share of the EU's total trade in services with around 34.8 percent and 12.6 percent, respectively). Today, the EU absorbs about 14 percent of Indonesia's exports to the world and is also the primary destination for Indonesia's non-oil and gas exports. The EU absorbs 15.3 percent of Indonesia's non-oil and gas exports to the world. Despite this, trade relations between Indonesia and the EU remain asymmetrical. While the EU's share of Indonesia's total trade represents about 12.4 percent, Indonesia's share of the EU's total trade only reaches 0.7 percent.

Figure 3.3: Export and import values between Indonesia and the EU, 1981–99 (USD million)



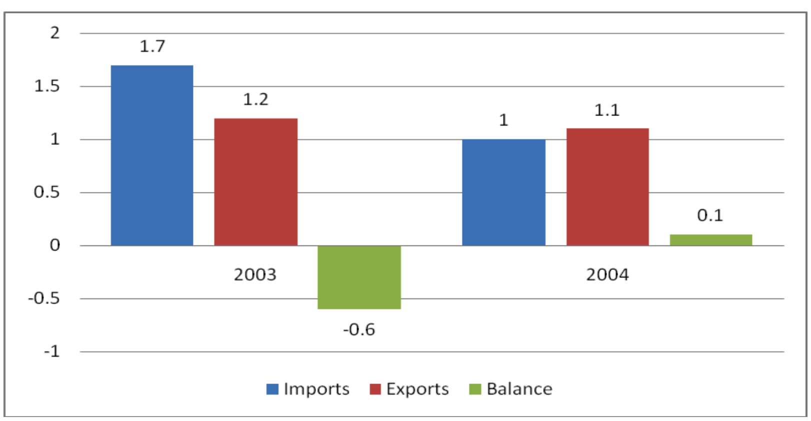
Source: Ministry of Trade of the RI and the Central Bureau for Statistics (compilation)

Figure 3.4: EU-25 merchandise trade with Indonesia, 2001–05 (EUR billion)



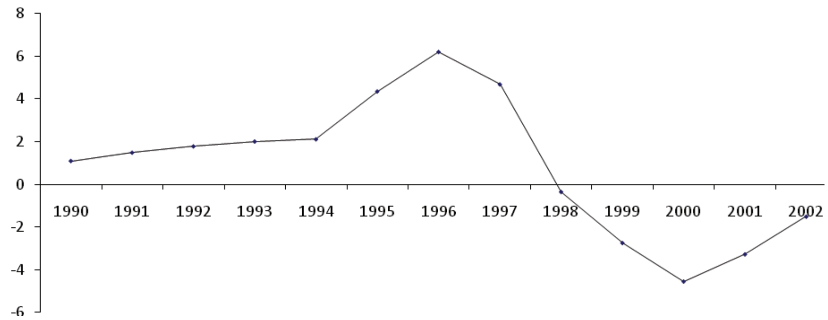
Source: DGTEC (2006b: 1)

Figure 3.5: EU-25 trade in services with Indonesia, 2003–04 (EUR billion)



Source: DGTEC (2006b: 1)

Figure 3.6: FDI net inflows to Indonesia, 1990–2002 (balance of payments, current in USD million)



Source: IMF (2003a; 2003b); World Bank (2003)

Table 3.4: EU FDI outflows to Far East Asian countries, 2001–05 (EUR million)

	2001	2002	2003	2004	2005
Total EU FDI	306,140	133,897	135,711	136,388	171,757
EU FDI in Far East Asia	64,767	18,227	14,666	26,367	25,872
Of which:					
India	353	1,075	767	1,452	2,170
Thailand	-398	517	315	349	366
Malaysia	-647	308	-120	1,074	696
Indonesia	121	-434	1,104	138	3,942
Singapore	9,647	7,669	2,772	2,679	1,082
Philippines	378	-78	-190	431	334
China (including Hong Kong, SAR)	51,408	6,417	6,960	14,240	6,638
South Korea	1,143	1,642	2,103	1,790	4,207
Taiwan	1,182	435	116	1,258	2,910
Newly industrialized countries (NICs)*	61,088	13,058	8,761	16,761	11,105
Other NICs**	-666	744	7	1,856	1,399
ASEAN	9,535	7,641	4,480	4,631	6,299

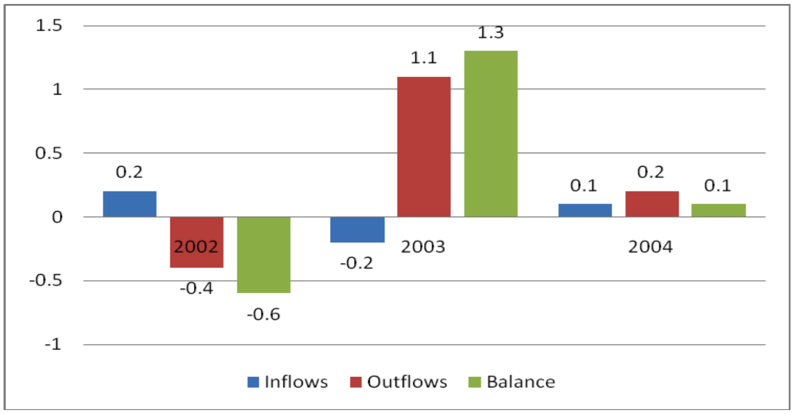
* Core NICs (Hong Kong, South Korea, Singapore and Taiwan).
** Asian NICs in the second wave of industrialization (Malaysia, the Philippines and Thailand).

Source: European Commission and Eurostat (2007: 72)

The EU also has a strong presence in Indonesia in terms of investment. Indonesia has attracted a large amount of FDI; in 1996, for instance, Indonesia ranked second after China as the major recipient of FDI in the Asian region (Jhamtani, 2007: 71). In addition, Indonesia was one of the key recipients of EU investment in the ASEAN region between 1995 and 2004, receiving a total of USD 3,776 million worth of investment from the EU. Prior to the 1997 economic crisis, EU investment in Indonesia was worth USD 636 million. This fell to USD 566 million in 2002 and USD 207 million in 2003. Foreign investment in Indonesia has fallen substantially since the 1997 crisis. Throughout the post-crisis period Indonesia saw significant net FDI outflows, ranging from USD 356 million in 1998–99 to a peak of USD 4,550 million in 2000 (Hutagalung, 2003). Although the crisis generated lower prices for assets, investors were reluctant to enter Indonesia. Figure 3.6 shows that net inflows of FDI from 1998 to 2002 remained negative because of capital flight. Currently, however, the EU is one of Indonesia's key investors. Indeed, the *European Union foreign direct investment yearbook 2007* (European Commission and Eurostat, 2007) notes that in 2005 EU investment in Indonesia rose quite significantly to EUR 3.9

billion compared, with EUR 138 million the previous year (refer to Table 3.4). Despite this, investment relations between the two still favour the EU. Between 2002 and 2004 the EU's trade presence in Indonesia was more significant than Indonesia's trade presence in the EU (refer to Figure 3.7).

Figure 3.7: EU-25 total FDI in Indonesia, 2002–04 (EUR billion)



Source: DGTEC (2006b: 1)

Trade and investment regimes and policymaking in ASEAN and Indonesia

Trade and investment regimes in ASEAN and Indonesia

Today, the Southeast Asian region is one of the most open economic regions in the world. With the exception of the newer member countries, such as Cambodia, Lao PDR, Myanmar and Vietnam (also known as the CLMV countries), the economies of ASEAN countries are small and open in comparison to those of the EC, or the EU today (Plummer, 2005: 42). Southeast Asia has a long history in international trade (Dent, 1997: 37); e.g., the region has provided passages for traders between China and the Indian subcontinent for centuries. Most ASEAN member countries are currently tied into the network of international markets and trade institutions. In Indonesia, Malaysia, Thailand and, to some extent, Vietnam, trade and investment liberalization initiatives were launched in the 1980s, while the Philippines fell under the spell of liberalization in the 1990s (Sally and Sen, 2005: 105). Singapore, on the other hand, had begun its export led industrialization process far earlier than the rest of its ASEAN counterparts.

The open nature of ASEAN economies is driven by both external and internal factors. Externally, global political economic changes in the late 1980s and early 1990s gave way to the liberalization of trade and investment regimes in ASEAN countries. The appreciation of the Japanese yen and the signing of the Plaza Accord[48] in the mid-1980s paved the way for increased Japanese investment in Southeast Asia,

48 The Plaza Accord was signed by finance ministers from five leading industrialized countries, i.e., the U.S., Japan, West Germany, France and the UK, in New York on 22 September 1985. Under this accord, each country made specific promises on certain economic policies. The U.S., for example, pledged that it would cut the federal deficit, while Japan committed itself to implementing a looser monetary policy and a range of financial sector reforms. In general, however, the five countries agreed to depreciate the value of the U.S. dollar in relation to the Japanese yen and German mark. The exchange value of the dollar against the yen declined by as much as 51 percent in the two years following the signing of this accord. Although the accord was also

which resulted in Japanese firms supporting REI in Southeast Asia in order to achieve cost minimization in the production process and capital movement across the region (Webber, 2001: 349). Secondly, the growth of the Chinese economy and the economies of the newly independent states of the former Soviet Union in the early 1990s also posed a threat to the overall competitiveness of Southeast Asian states (Yew, 2000: 382; Lim, 2001: 191–92), and ASEAN had to come up with a more attractive trade and investment liberalization package to stay ahead of the competition. The third external factor, which is related to the second, concerns both the established and new REI initiatives in other regions, such as Western Europe's Single Market Programme and the North American FTA (NAFTA) among the U.S., Canada and Mexico. These initiatives encouraged trade and investment liberalization initiatives in the ASEAN region. This period also saw ASEAN member countries start to engage in many transregional arrangements, such as APEC, thereby forcing ASEAN member countries into making a commitment to trade and investment liberalization.

Internally, economic actors in ASEAN were also responsible for the liberalization of trade and investment regimes in their region. Following the surge of trade liberalization in the mid-1980s, ASEAN economic actors began to see the increasing diversification of production structures and the complementarity of ASEAN economies as a result of the growth of transnational corporations and the strengthening of industrialization processes within most ASEAN countries (Tongzon, 2002: 182). ASEAN economic actors were also worried about external threats to the competitiveness of Southeast Asian economies. In Malaysia, for example, economic actors were concerned about China's capacity to alter both the strategic balance and economic growth patterns of Southeast Asia (Means, 1995: 163). Economic actors in both Singapore and Indonesia, on the other hand, were worried about the future trade diversion effects from NAFTA and the EU. Indonesian economic actors, as Means (1995: 168) further notes, feared that the creation of NAFTA would bring major changes to the GSP, which would affect Indonesia's exports to North American markets. Many ASEAN policymakers at the time also started to realize the necessity of adjusting their protectionist policies to accommodate global political economic changes. These factors contributed to the mushrooming of REI initiatives in ASEAN and also paved the way for more liberal trade and investment regimes in the region.

The 1997 economic crisis also led to a push for more liberal trade and investment regimes in many Southeast Asian countries. This is particularly true of Indonesia and Thailand, two of the countries that were badly hit by the crisis. International financial institutions, such as the International Monetary Fund (IMF) and the World Bank, proposed trade and investment liberalization programmes to help these countries recover. Half-hearted commitments to trade and investment liberalization were made throughout Southeast Asia, driven partly by China's entrance into the WTO and India's growing importance in the global economy. This also led to closer cooperation between ASEAN and China by means of the ASEAN–China FTA, which later contributed to the development of a wider web of bilateral FTAs entered into either by ASEAN as a whole or by its individual member countries.

Trade and investment policies in Southeast Asia have been used mainly to support broader industrial policy. The industrial policy objectives of the ASEAN states often include measures such as tariffs and non-tariff barriers (NTBs) to either protect local industry or to foster national production. Table 3.5 shows the relative openness of ASEAN countries, among which the city state of Singapore is by far the

successful in reducing the U.S. trade deficit vis-à-vis Western European countries, it failed to alleviate the U.S. trade deficit with Japan. The recessionary effect of the strengthened yen created an incentive for the expansion of monetary policy in Japan, which subsequently led to the Japanese asset price bubble in the late 1980s and also the growth of Japanese investment in Southeast Asia. For further information about the Plaza Accord, see, inter alia, <http://www.economist.com/research/Economics/alphabetic.cfm?LETTER=P#plazaaccord>.

most open economy in the region, followed by Brunei Darussalam, Indonesia, Malaysia and the Philippines. In most ASEAN countries, NTBs are more of an obstacle than tariff barriers. In the area of agriculture protection, Thailand and the Philippines are the two most protectionist countries in the region, while Malaysia and Thailand are the two most protectionist countries with regard to the industrial sector. In the industrial sector, tariff protection is mainly associated with the automotive industry.

Table 3.5: Overall openness of ASEAN countries' trade policy regimes

Country	Trade Restrictiveness Index (IMF)*			Trade component of the Economic Freedom Index**	Trade policy component of the Economic Freedom Index, 2006*	Messerlin**	
	Tariff	NTBs	Overall	Fraser Institute	Heritage Foundation	Agriculture	Industry
Brunei	1	2	4	n/a	n/a	n/a	n/a
Cambodia	3	2	6	n/a	4	n/a	n/a
Indonesia	1	2	4	7.3	3	7.4	8.3
Lao PDR	1	3	7	n/a	4.5	n/a	n/a
Malaysia	1	2	4	7.6	2.5	8.2	7.8
Myanmar	1	3	7	1.9	5	n/a	n/a
Philippines	1	2	4	7.3	2.5	6.7	8.7
Singapore	1	1	1	9.5	1.0	n/a	10
Thailand	2	2	5	7.5	3.5	6.5	7.8
Vietnam	3	3	9	6.9	4.5	n/a	n/a
EU			4	8.0	2.0	7.0	9.6

Notes:
* The higher the score, the more restrictive the economy.
** The higher the score, the less restrictive the economy.

Source: Consortium of Euro-Asia Centre and IFRI (2006: 61)

Table 3.6: The level of binding coverage, and bound and applied tariffs in ASEAN-10 and EU-25, 2007

Country	Binding coverage (%)	Final bound tariffs (%)*			Applied (%)*		
		Agricultural	Non-agricultural	All goods	Agricultural	Non-agricultural	All goods
Brunei	95.3	30.5	24.5	25.3	5.2	3.0	3.3
Cambodia	100	28.1	17.7	19.0	18.1	13.7	14.3
Indonesia	96.6	47.0	35.6	37.1	8.2	6.8	6.9
Lao PDR	n/a	n/a	n/a	n/a	19.5	8.2	9.7
Malaysia	83.7	79.7	14.9	25.1	12.3	7.9	8.5
Myanmar	17.4	102.2	21.1	83.0	8.7	5.1	5.6
Philippines	66.8	34.7	23.4	25.6	9.6	5.8	6.3
Singapore	69.2	27.6	6.3	10.4	0.2	0.0	0.0
Thailand	74.7	40.7	25.5	28.2	22.1	8.2	10.0
Vietnam	100	18.5	10.4	11.4	24.2	15.7	16.8
EU-25	100	15.4	3.9	5.4	15.1	3.9	5.4

Notes:
* Simple average of ad valorem duties.

Source: WTO (2007)

As a result of their commitment to open regionalism, tariff levels in most ASEAN member countries have tended to decline. As of April 2007 applied tariff rates are highest in Vietnam and Cambodia at 16.8 percent and 14.3 percent, respectively. Among the ASEAN-5 countries, applied tariff rates are highest in

Thailand (10 percent), followed by Malaysia (8.5 percent), Indonesia (6.9 percent), the Philippines (6.3 percent) and Singapore (0 percent) (refer to Table 3.6). Some of the newer members, such as Brunei Darussalam and Myanmar, have lower applied tariff rates, at 3.3 percent and 5.6 percent, respectively, than the average ASEAN-5 applied tariff rates (6.34 percent). Most ASEAN countries still choose to retain some form of flexibility to support domestic industries either through low binding coverage or the imposition of significantly higher bound tariffs than the existing applied tariff levels. Cambodia and Vietnam, the newer members of ASEAN, are by far the most committed to a liberal trade policy. Apart from high binding coverage, at 100 percent, the difference between the existing applied and bound tariffs in each country is relatively low. Among the ASEAN-5 countries, however, Indonesia and Malaysia lead in terms of binding coverage, at 96.6 percent and 83.7 percent, respectively, although the difference between the applied and bound tariffs is quite significant in both countries. As for the Philippines and Thailand, both countries do not only have lower binding coverage, at 66.8 percent and 74.7 percent, respectively, but they also impose significant differences between their existing applied and bound tariff levels.

Apart from tariffs, ASEAN countries use other measures to regulate imports and exports, such as import prohibition, licensing, import surcharges, special duties, excise taxes, import quotas, state trading enterprises, and export restrictions and supports. Studies conducted by Kettunen (2004) and the Consortium of Euro-Asia Centre and IFRI (2006) provide extensive and detailed analyses of these trade measures in ASEAN countries. In order to avoid duplication of these studies, the present study will highlight only some general key points relating to these trade measures. Import prohibition is normally employed in ASEAN countries for health, safety, security, moral or cultural reasons, or to protect infant industries. In the past, for instance, Indonesia applied import bans on completely built up motor vehicles, chemical products and plastic scrap in order to protect infant industries. By 1998 the number of sectors affected by import bans was reduced to about 40 tariff lines (WTO, 1998). In other ASEAN countries, such as Brunei Darussalam and Malaysia, the use of import restrictions for religious reasons is common, particularly with regard to bans on alcohol, beef and poultry products. Thailand, meanwhile, has used import prohibition to maintain economic stability and protect public interests. In the early and mid-1990s, for example, Thailand prohibited the import of items from South Africa and Yugoslavia.

The use of import licensing has been most apparent in Indonesia and Malaysia. This trade measure is normally used in relation to state trade enterprises or, as with import prohibition, for the protection of infant industries. In both countries, however, the use of import licensing has decreased considerably. By 1995, for example, both Indonesia and Malaysia had imposed import licensing on only 10 percent and 17 percent of their total imports, respectively. Among ASEAN countries, the Philippines has the most complex import licensing system (Consortium of Euro-Asia Centre and IFRI, 2006: 36). The president is permitted to prohibit imports from any country that discriminates against exports from the Philippines. The use of import quotas, or quantitative restrictions, is also prevalent among ASEAN countries, especially the ASEAN-5 countries. In Malaysia, for example, import quotas are applied to the completely built up motor vehicle industry. In the Philippines, although most quantitative restrictions were abolished by the end of the last decade, the country still imposes import quotas on rice. Similarly, Indonesia has in the past imposed import quotas on certain type of textiles (such as batik) and trucks. Singapore imposes import quotas on ozone depleting substances, while Thailand imposes quotas on garlic.

Exports are also subject to various regulations in many ASEAN countries. Indonesia has imposed extensive export bans, taxes and regulations affecting 40 percent of non-oil exports and 30 percent of production (WTO, 2001). Indonesia has also used excise taxes, which are normally imposed on foreign goods or goods produced by foreign owned companies, in its automotive sector. Luxury sales tax of up to 75 percent is targeted at imports of foreign automotive products. Thailand also imposes excise duties of between 0 and 48 percent. The use of export duties is also common in Malaysia. The Malaysian government has in the past imposed duties on certain exports, such as timber, in order to discourage exports and maintain prices within an affordable range.

As with their trade regimes, foreign investment policies in most ASEAN countries have relaxed. By neoliberal standards, Singapore has the clearest and fairest foreign investment regime in the ASEAN region, as both domestic and foreign businesses are treated equally. In recent years, Singapore has also carried out a number of reforms in its foreign investment policy, such as the removal of the 40 percent foreign shareholding rule in the services sectors and the 70 percent foreign ownership restriction of the Stock Exchange of Singapore. Malaysia has also relaxed its foreign investment policies in recent years. By 2003, for instance, all new manufacturing projects were fully liberalized and foreign investors were allowed to hold 100 percent of equity in these projects. In the Philippines, foreign investment regulations underwent significant changes even before the 1997 economic crisis. The country has allowed full foreign ownership since 1991. In terms of land ownership, however, the Philippines' Constitution still restricts all foreigners to 40 percent ownership, although they may also lease land for long periods. Indonesia and Thailand, however, underwent dramatic changes in their foreign investment policy following the 1997 economic crisis. The Alien Business Law, which had governed foreign investment issues in Thailand since 1973, was replaced by the 1999 Alien Business Act. The new Act grants greater access to foreigners who wish to invest in Thailand. Foreign equity limits were also relaxed in some financial sectors. Foreigners are now allowed 100 percent ownership for up to 10 years.

As in Thailand, foreign investment regulations underwent drastic changes in Indonesia since the 1997 economic crisis. As part of an IMF loan package, the Indonesian government agreed to remove all forms of restrictions on foreign ownership in companies listed on the Jakarta Stock Exchange in 1997. The government also agreed to open up the retail and wholesale sectors to foreign investment in 1998. Other initiatives were aimed at relaxing investment restrictions in other sectors, such as the financial sector, telecommunications, etc. In 2007 the Indonesian government launched the new Foreign Investment Law (Undang-Undang Penanaman Modal, or UUPM) to replace the outdated 1967 Investment Law. The key elements of this new UUPM are: (1) equal treatment of national and foreign investors; (2) a ban on nationalization and expropriation; and (3) the opening of investments in all sectors, except those declared closed or declared open with specific requirements (Jhamtani, 2007).[49] The new UUPM also extends the period of time foreign investors can lease land to an initial 65 years, with the possibility of extending this for another 35 years (Nusantara Networks, 2007: 2).

As mentioned earlier, trade and investment liberalization has also gone ahead at the regional level among ASEAN member countries. ASEAN is currently undergoing one of its most comprehensive economic integration projects: the ASEAN Economic Community (AEC). The AEC is one of the key pillars of the proposed ASEAN Community: a community that, it is hoped, will be formed by 2015. The Thirty-eighth ASEAN Economic Ministerial Meeting, held in Kuala Lumpur in August 2006, proposed that the AEC schedule be brought forward to 2015. The Declaration of the ASEAN Concord II, which defines the AEC as an end goal of ASEAN economic integration initiatives, sets out the essential requirements for equitable economic development, poverty reduction and narrowing the socioeconomic gap among the ASEAN population. In order to achieve these objectives, ASEAN pursues a neoliberal approach that favours the free flow of goods, services, investment and capital. In essence, most ASEAN

49 Defence related industries are closed to foreign investors conclusively.

regional economic integration initiatives, including the ASEAN FTA (AFTA),[50] the ASEAN Framework Agreement on Services (AFAS)[51] and the ASEAN Investment Area (AIA),[52] are directed at the creation of an AEC. So far, however, these regional economic integration initiatives have achieved mixed results. The AFTA, for example, has failed to promote intra-ASEAN trade, which still stands at around 23 percent of the association's total trade. Moreover, given the General Agreement on Trade in Services (GATS)-plus nature of ASEAN services liberalization measures, the AFAS has achieved little so far. For most ASEAN member countries, however, ASEAN REI has been a learning process towards getting involved in global liberalization. Lack of progress at the regional level does not necessarily invalidate member countries' attempts to set up liberal trade and investment regimes.

Trade and investment policymaking in ASEAN and Indonesia

In terms of trade and investment policymaking, however, the ASEAN member countries have not yet been able to surrender their sovereignty to the association. ASEAN is basically a forum for wide ranging consultation and cooperation, but lacks any specific supranational objective. Member countries still retain the power to determine their own individual trade and investment regimes. The economic decision making organ is the ASEAN Summit, which is a meeting of the leaders of ASEAN member countries to decide key issues and put forward major proposals. Economic issues, including trade and investment, are negotiated mainly at the Economic Ministerial Meeting, which is attended by economic, trade and industry ministers from ASEAN member countries. The ASEAN Secretariat was established in 1976, but it has no authoritative power over member countries. To date, the primary function of the secretariat is initiating, monitoring and implementing the policies decided upon by member governments. The Secretariat, therefore, only works for ASEAN member governments and cannot introduce its own policies without prior consultation with all ASEAN member governments. These limitations are still in place, despite attempts to upgrade the position of the secretary general to ministerial level in 1992.

At the multilateral trade level, ASEAN does not represent its member countries, although it is recognized as a regional trade bloc. ASEAN member countries often belong to different blocs in WTO negotiations. Due to their interests in protecting their agricultural sectors, for example, both Indonesia and the Philippines are members of the Group of 33 in the WTO's agricultural negotiations. This group

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50 The AFTA is the main trade liberalization initiative in ASEAN to date. This regional trade arrangement was initiated in the early 1990s to help fulfil ASEAN's desire to maintain its importance as an organization in the midst of international political economic change. It was also a response to the pressure from regional business actors for regional trade measures. The AFTA was officially launched during the Fourth ASEAN Summit in Singapore in 1992. Its implementation was complemented by the creation of a Common Effective Preferential Tariff scheme, which is the main mechanism that removes intraregional tariff and non-tariff barriers.

51 The AFAS was signed during the Fifth ASEAN Summit in Bangkok in 1995. It aimed to strengthen the region's service sectors and complement the AFTA. This service liberalization arrangement follows the structure and approach of the WTO's General Agreement on Trade in Services (GATS). The AFAS employs the so-called GATS-plus approach, whereby member countries are expected to give more commitment to this liberalization scheme than any scheme at the WTO level. Today, the ASEAN region has managed to enter the list of the top 10 world services exporters. However, the bulk of ASEAN's service exports still come from Singapore. Most member countries have yet to develop their services sectors to full capacity.

52 At its Fifth Summit in 1995, ASEAN called for a regional investment arrangement to enhance the effectiveness of FDI flows in the region. In 1998 the Framework Agreement of the AIA was signed. The primary objectives of the AIA is 'to attract greater and sustainable levels of FDI into the region and to realise substantially increasing flows of FDI from both ASEAN and non-ASEAN sources by making ASEAN an attractive, competitive, open, and liberal investment area' (ASEAN Secretariat, 1998).

advocates for the so-called Special Products Mechanism (SPM)[53] and Special Safeguard Mechanism (SSM).[54] In contrast, other ASEAN developing countries, such as Thailand, have been cautious about such mechanisms because of strong agricultural export interests. ASEAN's inability to act as a single bloc in the area of the economy and trade is demonstrated by the increase of BFTAs between individual ASEAN countries. Singapore, Thailand and Malaysia have all been signing up to BFTAs.

As one of ASEAN's more influential members, Indonesia plays a significant role in ASEAN policymaking. While the country has great influence in the area of political and security cooperation, it has little interest in leading the way in economic cooperation, and it is Singapore and, to a lesser extent, Thailand and Malaysia that lead ASEAN in this area. In the past, Indonesia had reservations about REI, and its vast geographical size and population, coupled with its tradition of trading with non-ASEAN members, made Indonesian economic players wary of supporting any REI initiatives. However, changes in the global political economy in the early 1990s heralded a mushrooming of regionalism. The rise of China and an Indonesian market that had become integrated with the global economy helped make Indonesian economic actors support the active role of the Indonesian government in international trade.

During both the New Order and Old Order regimes, economic policymaking was relatively simple and straightforward. Key decisions were made by the president and a handful of technocrats. The strong element of nationalism in its overall foreign economic policy (FEP) also made Indonesia relatively passive in international trade. Although the 1997 economic crisis brought economic problems to the Indonesian population, it also resulted in a wave of democratization that made Indonesian economic policymaking more complex. NGOs and other civil society organisations (CSOs) were now able to play a role in economic policymaking. Despite continuous reforms in the area of trade and investment, many Indonesian foreign donors felt dissatisfied with Indonesia's progress during the post-economic crisis period. Indonesia thus replaced its 1967 Investment Law with the Foreign Investment Law in 2007. In 2005 Indonesia had also restructured its international trade policymaking process to address 'the problem of the complex nature of the substance and process of international trade negotiations, as well as to improve co-ordination among related government institutions' (Chandra, 2007: 263). At the time, the Indonesian government decided to set up the International Trade Negotiation National Team (Tim Nasional Perundingan Perdagangan International, or TimNasPPI), which was ratified by Presidential Decree no. 28/2005 (18 October 2005). This team had several key objectives, which included: (1) analyzing the substance, process, outcome, impacts and other aspects of international negotiations; and (2) preparing and formulating the position and strategic approach of the Indonesian government in any international negotiation based on comprehensive and coordinated national interests. TimNasPPI is headed by the minister of trade and guided by the economic coordination minister. Members of TimNasPPI include all echelon 1 officials from related government institutions and the vice president of the Indonesian Chambers of Commerce and Industry (Kamar Dagang dan Industri Indonesia, or KADIN), as well as the Advisory Group. If deemed necessary, TimNasPPI is allowed to promote expert staff from the Advisory Group, the academic community, trade practitioners, industrial associations and NGOs.[55]

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53 Special products are products that are considered sensitive and thus excluded from trade liberalization.

54 An SSM allows a government to impose contingency restrictions on imports to deal with special circumstances, such as a sudden surge in imports.

55 The only civil society element in TimNasPPI is KADIN. Many trade advocacy NGO activists argue that existing trade policymaking and consultation mechanisms, such as the Indonesian WTO Forum and TimNasPPI, are still too exclusive and that their memberships should be broadened.

In Indonesia, it is difficult to identify which major interest groups are able to exert significant influence in economic policymaking. In the past, both the academic community and the private sector have played crucial roles in influencing Indonesian FEP. Increasingly, however, overall Indonesian FEP has been influenced by political leaders, including President S. B. Yudhoyono; Jusuf Kalla, the vice president; and others at the ministerial level, such as Aburizal Bakrie, the people's welfare minister.[56] In reality, both business groups and the academic community are nonetheless able to influence Indonesian trade and investment policy. NGO activists often complain, however, that civil society participation in international trade policymaking is still limited to traditional interest groups, such as KADIN, other business associations and a handful of trade experts.[57] Historically, KADIN's position in international trade issues has been generally protective. KADIN often fought hard to maintain high tariffs to promote the interests of its large conglomerate members, who then enjoyed the trade monopoly that resulted from the country's closed economic system. In recent years, KADIN, along with other Indonesian business associations, has pushed the Indonesian government towards signing BFTAs. The overwhelming assumption is that KADIN has a neoliberal approach to FEP, but its support for BFTAs is for defensive reasons. Apart from President Yudhoyono's role in initiating economic partnerships with major trading partners, Indonesia's competitors have been adopting a BFTA strategy. These factors have all played a part in pushing Indonesian exporters in the direction of BFTAs.[58]

Trade and investment regimes and policymaking in the EU

Trade and investment regimes in the EU

The desire to develop an effective regional institution is relatively strong in the EU. Unlike ASEAN, EU member countries have surrendered part of their sovereignty to Brussels, where the EU headquarters are based. Today, the European Commission, as the executive body of the EU, has the exclusive competence to formulate and implement various common regional policies, including trade policies. The EU's Common Commercial Policy (CCP) is mainly regulated by Article 133 of the EU Treaty,[59] which seeks 'to contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restriction on international trade and the lowering of custom barriers' (chap. I [3]).[60] Article 133 of the EU Treaty specifically calls for member countries to adopt a CCP that is based on uniformed principles, particularly in regard to changes in tariff rates, the conclusion of trade agreements, uniform liberalization measures and export policy. These principles also include various measures to protect trade, such as in the case of dumping and the imposition of subsidies (European Commission, 2003b).

56 Both Kalla and Bakrie represent large conglomerates with extensive business interests. Kalla owns the Bukaka and Bosawa Groups, which do business in infrastructure construction and transportation, while Bakrie owns the Bakrie Group, which has diverse business interests in many sectors, such as telecommunications, mining, etc.

57 Interview with David Ardian, executive director, Nastari, 13 October 2006 and Adriana Venny, researcher, *Journal Perempuan*, 27 September 2006.

58 Interview with Dr Hadi Soesastro, executive director, Centre for Strategic and International Studies, 19 October 2006.

59 The EU Treaty was signed in 1993, and later amended in 1999 by the Treaty of Amsterdam. Under the EU Treaty, three key pillars serve as the basic foundation for the EU. Pillar One includes the European Communities, the European Coal and Steel Community, and the European Atomic Energy Community. The Economic and Monetary Union is also part of Pillar One. Pillar Two includes foreign policy and security, while Pillar Three is concerned with justice and internal affairs.

60 The CCP's objectives are subject to the integration of environmental protection requirements with a view to promoting sustainable development. For details of the consolidated text of the EU Treaty, including details about the CCP, see, *inter alia*, Eur-Lex (2006).

A recent study conducted by Brülhart and Matthews (2007) highlights a number of key features of the EU's CCP. Firstly, while the original focus of EU commercial policy was targeted at tariffs and other border measures that affect trade in goods, policies that affect trade in services and foreign investment have become increasingly important in current EU commercial policy. Secondly, the EU has developed highly complex trade relations with third countries. Its preferential trading scheme has been determined by a mixture of trade related, strategic and foreign policy concerns that have emerged from both regional institutions and member countries. Thirdly, the commercial policy of the EU is increasingly shaped by its obligations to the WTO. The EU, like its predecessor, the EC, was an active player in both the Uruguay Round, which established the WTO, and the Doha Round. The EU has been a key player in the current Doha Round of negotiations.

In order to achieve its commercial policy objectives, the EU has simultaneously adopted multilateral, regional and bilateral approaches to trade and economic relations. In addition to its export and import policies, it also has a market access strategy vis-à-vis third countries, which is published on the Market Access Database. This annually updated database provides information on barriers to trade in third country markets.[61] Another important instrument in the EU's external trade policy is the trade sustainability impact assessment (SIA), which is a research or feasibility study undertaken during trade negotiations for the purpose of identifying the potential economic, social and environmental impacts of any given trade agreement (European Commission, n.d.b). A trade SIA was first undertaken in 1999 when the EU was about to engage in a new round of WTO trade negotiations. The EU carried out more assessments to examine its broad commitment to sustainable development.[62]

Table 3.7: The EU's world merchandise trade, 2006

No.	Exports and imports	Value	
		EUR billion	%
1	EU-25	2,516.6	17.1
2	U.S.	2,296.5	15.6
3	China	1,312.1	8.9
4	Japan	921.5	6.3
5	Canada	609.6	4.2
6	Others (excluding intra-EU trade)	7,021.7	47.9

Source: European Commission (2006b)

As the world's largest trading bloc, the EU takes a significant chunk of global merchandise exports. In 2006, for instance, the EU-25 swallowed up 17.1 percent of total global merchandise trade (refer to Table 3.7). Between 1995 and 2005 EU-25 trade volumes grew by more than 6 percent in real terms. Traditionally, the U.S. has been the EU's largest trading partner and in 2006 alone it absorbed a significant 17.6 percent of the EU's total merchandise trade with the world (refer to Table 3.8). Today, nearly 46 percent of the EU's external trade is conducted with other developed countries. Apart from

61 The European Commission also publishes an annual report on barriers to trade and investment imposed by the U.S., the EU's major trade partner. Based on the information in this report, the European Commission, with guidance from the Article 133 Committee, identifies the way in which these barriers can be removed through diplomatic or formal processes, either at the multilateral or bilateral level. The EU's Market Access Database is available at <http://mkaccdb.eu.int/mkaccdb2/indexPubli.htm>.

62 Trade SIA studies are normally carried out by independent external consultants chosen through an open call for tenders. In order to ensure transparency, all studies carried out by these external consultants must be published on the DGTEC website.

the U.S., Japan, Switzerland, Norway and Canada are also major EU trade partners. If intra-EU trade and extra-EU trade with developed countries are combined, it shows that about four-fifths of the EU's external trade is conducted with countries with similar income levels (Brülhart and Matthews, 2007: 924). EU trade with developing countries accounts for about 43 percent of its total external trade. Despite this, developing countries only take about 14 percent of total EU trade. While the EU's trade with developed countries consists of manufactured goods, its trade with developing countries is more varied. About 12 percent of exports from developing countries to the EU are primary agricultural products, followed by 21 percent of fuel and other products. Given that many developing countries are undergoing a process of transformation from being mainly agricultural producers to manufacturers, the export of manufactured goods from developing countries to the EU has risen dramatically in recent years. In 1980 manufactured goods accounted for only 18 percent of total exports from developing countries to the EU. This increased to 67 percent in 2004.

Table 3.8: The EU's major trading partners, 2006

Rank	Trading partners	Value of exports from and imports to the EU	
		EUR million	%
1	U.S.	443,486	17.6
2	China	254,590	10.1
3	Russian Federation	208,638	8.3
4	Switzerland	157,214	6.2
5	Japan	120,219	4.8
6	Norway	117,075	4,7
7	Turkey	84,838	3.4
8	South Korea	60,874	2.4
9	India	46,355	1.8
10	Canada	45,991	1.8
11	Others (excluding EU-25)	977,324	38.9

Source: European Commission (2006c)

Table 3.9: OECD support for the agricultural sector, especially by the EU and U.S., 1986–88 and 1999–2001 (USD billion)

Country	1986–88 (annual avg.)	1999–2001 (annual avg.)	1998	1999	2000	2001
OECD	302	330	339	357	321	311
EU	110	113	125	130	102	106
U.S.	69	95	91	99	92	95

Source: Pursito (2007: 52)

Tariff levels in the EU are generally low. Its average bound and applied tariffs are identical at 5.4 percent. The average applied tariff level is higher for agricultural products, at 15.7 percent, than for non-agricultural products, at 3.9 percent. The tariff rate for agricultural products can go as high as 209.9 percent. Although tariff lines are generally low, the EU still exercises a number of measures to restrict imports. Value added tax and excise duties are applied to imports and many locally produced goods at similar rates due to fiscal harmonization among EU member states. Import licensing is also commonly used by the EU to maintain or monitor safeguards, technical requirements, quota management and on the grounds of surveillance (Consortium of Euro-Asia Centre and IFRI, 2006: 55–56). In addition to import restrictions, the EU also imposes other measures, such as subsidies, on its exports. These are permitted on the grounds of public concern (i.e., public morality; national cultural treasures; and to protect the wellbeing of humans, animals and plants). The agricultural sector has been the key benefactor of this protective policy. Although the EU has made continuous efforts to reform its

Common Agricultural Policy (CAP),[63] its agricultural sector is still safeguarded by tariff protection and domestic support. This policy does not only limit foreign competition in the EU market, but also affects the world agricultural market. Between 1986 and 1988 and between 1999 and 2001, for example, the EU was a main subsidy provider among member countries of the Organization for Economic Cooperation and Development (OECD) (refer to Table 3.9). Between 1986 and 1988 the EC provided an average USD 110 billion in annual subsidies to its farmers. This figure rose to USD 113 billion a decade later.

The EU has a strong policy of competition that pushes its member countries to adopt open, competitive economic policies. This spirit of competition was reflected in the 1957 Treaty of Rome, the aim of which was to improve consumer welfare and enhance the competitiveness of European industry. Articles 85 and 86 of the Treaty of Rome form the basis for Europe's policy of competition. Article 86 specifically prohibits (1) the direct or indirect imposition of unfair purchase or selling prices or unfair trading conditions; (2) the limitation of production, markets or technical development to the prejudice of consumers; (3) applying dissimilar conditions to equivalent transactions with other trading parties, which may place them at competitive disadvantage; and (4) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations that have no connection with the subject of such contracts.[64] Since the mid-1990s, however, the EU has tried to reform its policy on competition, particularly in the area of standard competition regulations, in the field of trade in services, and in its treatment of monopolies and cartels. An improved policy was launched in 2004. Two important points are worth noting. Firstly, the decentralization of power enables member state institutions to enforce competition regulations in accordance with regional standards. Secondly, the use of a *one-stop shop* principle in the EU's merger regulations gave the European Commission exclusive control over any major cross border mergers. This was improved with the new Merger Regulation (regulation (EC) no. 139/2004), which encourages national competition authorities to get involved in cross border mergers. The new regulation should simplify notification and investigation procedures of cross border mergers.[65]

The EU's IPR regulation is one of the most advanced in the world and is governed by both national and regional regulations. The EU considers a strong IPR regulation a prerequisite for protecting the export of products, technologies, designs, etc. against any kind of infringement. The current official policy of the DGTEC on IPR is fivefold: (1) to promote the implementation of effective standards for intellectual property (IP) protection worldwide, with the WTO agreement on Trade-Related Aspects of IPR as the minimum standard of IP protection; (2) to promote an adequate enforcement of IPR worldwide; (3) to ensure that IPR can support the objectives of public health, promote innovation and assist the transfer of technology; (4) to cooperate with developing and least developed countries to improve and strengthen their IPR laws; and (5) to reach specific objectives during the new rounds of WTO negotiations.[66]

63 The CAP is one of the most controversial agricultural policies in the world. While some consider the CAP the EU's most successful policy, others see it as a scandalous waste of money (BBC News, 2005). The policy, launched in 1962, permits the EU to intervene in buying agricultural products when market prices fall below an agreed target level. Although this policy helped to reduce Europe's dependence on food imports, it also led to overproduction and surpluses in agricultural products. In 2005 alone, the EU spent 46 percent of its budget, or about EUR 49 billion, to support the CAP. Among the member countries of the EU, France is the main beneficiary of CAP funds, taking about 22 percent of the total in 2004, followed by Spain (12 percent) and Germany (15 percent). It is also important to note that in all EU member countries the majority of CAP funds go to large scale farmers, such as large agribusinesses and hereditary landowners. About 80 percent of CAP funds go to a mere 20 percent of EU farmers, while the majority of EU farmers share just 8 percent of these funds (BBC News, 2005). For further information on the CAP and EU activities in the agricultural sector, see <http://europa.eu/pol/agr/index_en.htm>.

64 Further details of the Treaty of Rome are available from the website of the Hellenic Resources Network, <http://www.hri.org/docs/Rome57/>.

65 Further details on the EU's competition policy are available from <http://ec.europa.eu/comm/competition/index_en.html>.

66 For further details on the EU's current official policy on IPR, see the official DGTEC website, <http://ec.europa.eu/trade/issues/sectoral/intell_property/index_en.htm>.

Another prominent feature of the EU's trade policy is anti-dumping or countervailing measures. Many of these measures are targeted at Asian countries. Between 1995 and 2004 Asia accounted for about 62 percent of the EU's anti-dumping actions and 58 percent of applied measures, with China as the major target for EU action (Consortium of Euro-Asia Centre and IFRI, 2006: 58). The member countries of ASEAN have also been a key target for the EU's anti-dumping measures. Between 1985 and 1990, for example, ASEAN-5 countries were subject to 11 anti-dumping investigations by the European Commission, representing about 5.3 percent of total EU anti-dumping investigations (Dent, 1997: 62). The number of anti-dumping investigations against ASEAN countries rose to 47 between 1991 and 1997. During this time, Thailand, Malaysia and Indonesia were subjected to the majority of the European Commission's anti-dumping investigations (with 16, 13 and 11, respectively).

Finally, the GSP also plays a significant part in EU external trade policy. The GSP is mainly aimed at simplifying and harmonizing procedures in order to improve developing countries' access to the EU market. The EU's GSP offers lower tariffs or completely duty free access for imports from 178 developing countries and territories to the EU market (European Commission, 2004). The EC's original GSP scheme, which was launched in the early 1970s, enabled selected exports from beneficiary countries to enter the EC market. These exports were subject to a quantitative restriction, which limited the quantity of the good or services that were traded.[67] Since 2001, however, the EU's GSP scheme incorporates an *Everything But Arms* initiative that does not impose quantitative restrictions on least developed countries. Although many ASEAN countries are beneficiaries of the EU's GSP scheme, most of the beneficiaries are former European colonies in the ACP under special agreements known as the Lomé Convention and the Cotonou Partnership Agreement.

Trade policymaking in the EU

As the highest decision making body in the EU, the European Council provides political direction and guidance to the organization. The European Commission, on the other hand, has exclusive rights to propose Community Acts, which may include regulations, directives (requiring transposition into the laws of member states), and practice (i.e., internal market legislation) (European Commission, 2003b). Not all decisions are made through a uniform decision making procedure. Decisions can be made by the European Commission or the European Council, or by both the European Council and the European Parliament. EU institutions generally decide whether member states can join international negotiations. Member states can also join unilaterally (Young, 2004: 204). Several regional institutions stand out in terms of trade policymaking processes. These regional institutions are the European Commission, the Article 133 Committee, the Committee of Permanent Representatives (COREPER), the Council of Ministers and the European Parliament.

As the executive body of the EU, the European Commission is permitted to initiate a trade proposal and become involved in actual international trade negotiations, and can coordinate positions and actions between the EU and its member states (Euforic, 2006). The Article 133 Committee, which is named after the relevant article of the EU Treaty, is a working group of the European Council. The committee comprises representatives from each member state and is normally chaired by whichever member holds the EU Presidency at the time (UK Department for Business, Enterprise and Regulatory Reform, n.d.). The committee normally discusses a range of trade policy issues that affect the EU on a weekly basis, including strategic issues surrounding the rounds of WTO negotiations, the export and import of

67 Quantitative restrictions on trade in services are normally used to restrict the number or activities of foreign service providers rather than the services themselves. This is because the services are more difficult to measure.

specific products, and the consistency of the EU's policy. Furthermore, COREPER is mainly responsible for preparing the work of the European Council and works in two configurations. While COREPER I consists of deputy permanent representatives that deal with technical matters, COREPER II is composed of the ambassadors from EU member states who deal with political, commercial, economic or institutional matters. COREPER coordinates around 250 committees and related institutions, and, like the Article 133 Committee, is chaired by the ambassador of the member country that holds the EU Presidency at any given time. COREPER plays a pivotal role in decision making processes in the EU, as it acts as a forum for dialogue among the permanent representatives and their respective capitals, and as a means for political control that guides and supervises the work of the expert groups.[68]

In addition to those regional institutions, there is also the Council of Ministers and the European Parliament, both of which are crucial to trade decision making processes. The Council of Ministers, also often referred to as the Council of the EU or simply the Council, and the European Parliament form the highest legislative body within the EU. The Council consists of ministers from each member country. Which ministers represent their countries in the Council depends upon the area or issues being addressed. Economic and trade ministers from member countries, for example, deal with trade related issues, including BFTAs and EPAs.[69] The European Parliament is composed of 785 members. Although it has legislative power, it does not have the legislative initiative of national parliaments. The power of the European Parliament, as with that of the Council of Ministers, is limited to the competencies conferred upon the EU by its member states. In other words, it has little control over the specific policy areas held by member states.[70]

The EU's trade policymaking procedure normally starts with a proposal from the European Commission, which is submitted to and discussed by the Article 133 Committee. The proposal then normally goes to COREPER, where it is discussed by the EU permanent representatives. COREPER then gives an assessment of the proposal to the General Affairs and External Relations Council (GAERC), which is composed of one ministerial representative from each member state.[71] These representatives decide on a negotiating mandate, which is then presented to the European Commission. On behalf of the EU member states, the European Commission, in consultation with the Article 133 Committee, carries out the actual negotiations with the EU's trade partners. After reaching an agreement with its trade partners, the EU's Council of Ministers make a final decision on whether to adopt or cancel the agreement through qualitative majority voting. Although the European Parliament has little power to veto the final decision of the Council of Ministers, it can assess the proposed trade arrangement with regard to budget management and implementation procedures. The implementation of any trade agreement between the EU and its partners will then be monitored by the Council of Ministers and the European Parliament.

EU trade policymaking processes have their own drawbacks. Firstly, the policymaking process in the EU is extremely complex and often requires that member states are willing to compromise. Despite the advance of regionalism, EU member states still face the problem of trying to find common ground, and individual state interests still prevail over regional interests. Secondly, the EU decision making process is still hampered by a lack of democracy. A national or regional institution is said to have a democratic deficit if it is unable to fulfil the principles of democracy in its modus operandi. Indeed, despite the multitude of actors in the EU policymaking process, the core decisions in EU trade policy still rest with the bureaucratic elements of institutions, particularly in member states.

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68 For further information about COREPER, see, *inter alia*, <http://europa.eu/scadplus/glossary/coreper_en.htm>.

69 For further information about the Council of Ministers, see, inter alia, <http://en.wikipedia.org/wiki/Council_of_the_European_Union>.

70 For further information about the European Parliament, see <http://www.europarl.europa.eu/>.

71 For further information about the GAERC, see <http://ec.europa.eu/external_relations/gac/index/htm>.

In recent years, however, the EU has attempted to improve its image by allowing greater input from CSOs, including academic think tanks, the business community and NGOs, and the European Commission has held dialogues with civil society groups to discuss a range of key issues and concerns regarding the EU's proposed BFTAs. On December 2006, for example, the European Commission held a dialogue with civil society groups to discuss the ways in which FTAs can help tackle global challenges.[72] Moreover, in preparation for the negotiations between the EU and its three Asian partners, South Korea, ASEAN and India, the European Commission met with civil society groups in April 2007. So far, however, business groups have been the most influential influence on the EU's trade policy. In an analysis of corporate power and the EU's trade policy, Stichele *et al*. (2006: 10–11) argue that 'lobbying Brussels has become a key instrument for business to integrate its interests in the European power structure'. The same study also suggests that the number of lobbyist in Brussels can reach as many as 15,000, 70 percent of whom work directly or indirectly for corporate interests, with only 10 percent working for NGOs and trade unions. A number of analysts, such as Gunnell (2005), also argue that the 'EU laws affect us all, but [it is] the corporate lobbyists who have the biggest influence on them'. It is remains to be seen whether the proposed AEUFTA really reflects the interests of European citizens.

Concluding remarks

This chapter has identified the key characteristics of existing trade and investment policies in both ASEAN and the EU. It has also analyzed the trade and investment policymaking processes in both regions. On the surface, it would appear that trade and investment relations between ASEAN and the EU are growing. Indeed, trade between the two regional groupings has been improving since their relationship was formalized in the early 1980s. In general, ASEAN–EU investment relations mirror the overall trend of trade relations between the two sides. These trade and investment relations, however, remain asymmetrical. While the EU is considered to be an important economic partner for ASEAN, the opposite does not hold true. A study conducted by the Consortium of Euro-Asia Centre and IFRI (2006: 114–24) has shown that ASEAN's economic importance to the EU remains small. This is due in part to ASEAN's comparatively small economies. In the area of investment, for example, the EU is a major contributor of FDI to the ASEAN region, while ASEAN FDI in the EU is still minuscule.

Although there is little doubt that an AEUFTA will expand overall economic relations between ASEAN and the EU, there is also clear evidence that it could deepen the asymmetry in their economic relationship. The developing and least developed member countries of ASEAN are still coping with the economic costs of adjustment associated with implementing open economic regionalism. Further trade and investment liberalizations under the AEUFTA are likely to create an additional burden for ASEAN economies. Therefore, the asymmetry in economic relations between the two regional groupings is likely to widen with this trade agreement.

The challenge of the AEUFTA beyond purely economic issues rests in the policymaking processes of this trade arrangement. As clearly illustrated in this chapter, trade and investment policymaking processes in both regions have tended to serve the interests of large economic actors, while civil society groups have been largely ignored. There have been efforts to remedy this problem in both regions, however. The EU, for instance, has put significant effort into improving its image by allowing input from a wider range of participants, including academic think tanks, business communities and NGOs. ASEAN, after years of being an elitist institution, is also slowly opening the door to wider civil society participation in its decision making processes. However, it remains to be seen how wider civil society concerns can be fully articulated in the proposed AEUFTA.

72 For a detailed report on this dialogue, see <http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_131954.pdf>.

Chapter 4 – The Impact of EU FDI and Export Growth on Indonesia under the ASEAN–EU BFTA: A CGE Model Analysis

Introduction

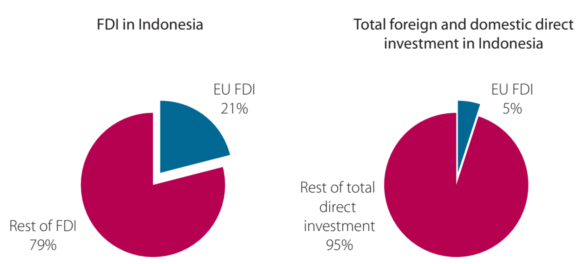
Under the existing TREATI, both ASEAN and the EU aim to expand trade and investment flows between the two regions (Consortium of Euro-Asia Centre and IFRI, 2006). Many empirical studies have assessed the costs and benefits of an FTA. Most of these studies support the idea of free trade between nations. The current state of ASEAN–EU economic relations, however, suggests that the EU is of far greater importance to Indonesia than Indonesia is to the EU (European Commission, 2003a). Apart from providing an analysis of trade issues, this chapter sets forth the results of a quantitative study that analyses investment under the proposed AEUFTA. This quantitative analysis is supported by the Equilibrium Model with Economic Regional Analysis Dimension (EMERALD), which is a computative general equilibrium (CGE) model adapted specifically for Indonesia. For the purpose of discussion, two scenarios are examined whereby (1) capital inflows from the EU to Indonesia grow by 10 percent; and (2) Indonesian exports to the EU grow by 18.5 percent.

In the first scenario, it is argued that capital inflows from the EU reduce the overall welfare of Indonesian households. The EU's objective in capital expansion is to gain a greater market share than it had prior to signing an AEUFTA. A fall in income among Indonesian economic actors is expected as a result of stiff competition from EU investment. EU investment in Indonesia is likely to focus on serving Indonesian domestic consumption. Although in this scenario real investment and export grow by 0.99 percent and 2.65 percent, respectively, the Indonesian economy as a whole gains only slightly from the expansion of EU investment in Indonesia. This economic modelling analysis also suggests that, under the AEUFTA, Indonesian household expenditure or consumption might fall by 0.11 as result of capital inflows from the EU. Although EU investment will stimulate employment growth, this growth will not compensate for the profits lost by Indonesian economic actors.

In the second scenario, it is expected that Indonesia will see a 0.48 percent increase in household income. Export growth of 18.5 percent is likely to increase investment by about 0.16 percent, and in the long run, the effect of export growth is also likely to increase the productivity of Indonesian economic actors. In these circumstances, real wages can be expected to rise by as much as 0.50 percent, leading to an improvement in the welfare of Indonesian economic actors. Although the long term effects of an expansion in Indonesian exports to the EU are positive for Indonesian economic actors, trade to the EU remains minimal.

Investment

Figure 4.1: EU share of direct investment in Indonesia, 2002–06 (%)



Source: BKPM (2007)

Table 4.1: FDI in Indonesia, 2002–06 (USD million)

	2002	2003	2004	2005	2006	Average share (%)
ASEAN	299	464	916	2,250	927	17
Asia non-ASEAN	574	1,018	1,418	2,060	1,676	24
EU	918	1,057	862	2,268	821	21
Other Europe	56	11	72	95	75	1
America	68	156	209	149	153	3
Australia	86	6	209	45	9	1
Africa	123	1,828	457	944	700	15
Joint country	967	911	459	1,104	1,616	18
Total	3,091	5,451	4,601	8,915	5,977	100

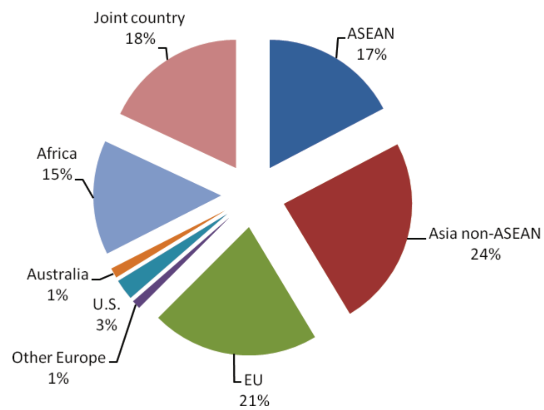
Source: BKPM (2007)

The data used in this section is taken from the Indonesian Investment Coordinating Board (Badan Koordinasi Penanaman Modal, or BKPM).[73] The investment figures in this section, however, only account for the value of new investment projects, thus excluding the value of the expansion of existing investment in Indonesia. In addition, the data used in our analysis excludes investment in the following sectors: oil and gas, banking, non-banking financial institutions, insurance and leasing, and mining. It should also be noted that the investment realization recorded by BKPM accounts for only 40 percent of the total approved value. In comparison, a similar discrepancy between the approved and realized figure of foreign investment occurred between 1967 and 1977 (or within the first 10 years of Indonesia's Law no. 1/1967 on Foreign Investment) when actual investment at the time reached only 42 percent of the intended figure (Himawan, 1980). Figure 4.1 illustrates the average share of FDI compared to total investment during the period 2002–06, as recorded by BKPM. It shows that FDI from EU member countries equalled about 21 percent of total FDI in Indonesia, which accounts for about 5 percent of total direct investment in Indonesia.

Between 2002 and 2006, Indonesia experienced an increase in total FDI. The highest FDI for Indonesia was recorded in 2005, reaching a value of about USD 8,915 million. A year later, however, the total value of FDI in Indonesia decreased to USD 5,977 million. The chairman of BKPM, M. Lutfi, acknowledged that increases in fuel price and prolonged electricity and gas supply problems throughout 2006 discouraged investment in the country (Hudiono, 2006). At the time, the Indonesian government was also under heavy pressure from potential investors to improve law enforcement, taxation, customs and excise, infrastructure, and labour relations in the country. From 2005 to 2006 joint country direct investment grew from USD 1,104 million to USD 1,616 million, while investment from the major investing countries in ASEAN and non-ASEAN countries, including the EU, fell. In line with the overall trend of investment in Indonesia, total FDI from the EU in Indonesia reached its peak in 2005 at about USD 2,268 million, and later dropped to USD 821 million in 2006 (this was even lower than the EU's investment in Indonesia in 2002, which was worth USD 918 million). Overall, FDI from Asian countries that are not ASEAN members contributed to about 24 percent of total FDI in Indonesia between 2002 and 2006, followed by the EU (refer to Figure 4.2). Among EU countries, the UK contributed about 50 percent of total EU FDI in Indonesia, followed by the Netherlands (33 percent), France (7.4 percent), Germany (6 percent), Belgium (2 percent) and other EU countries (1 percent) (refer to Figure 4.3). EU FDI can be further broken down by industry, as shown in Table 4.3. Investment in transport and communications was the largest FDI component at 36 percent, followed by metals, machinery and electronics (13 percent); chemicals (11 percent); food (7.3 percent); and trade (7 percent) (refer to Figure 4.4).

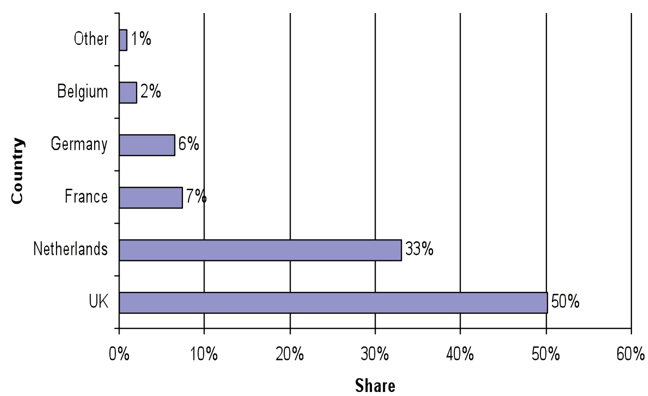
73 See, for example, BKPM (2007).

Figure 4.2: FDI in Indonesia by region, 2002–06 (%)



Source: BKPM (2007)

Figure 4.3: Share of EU direct investment in Indonesia by country, 2002–06 (%)



Source: BKPM (2007)

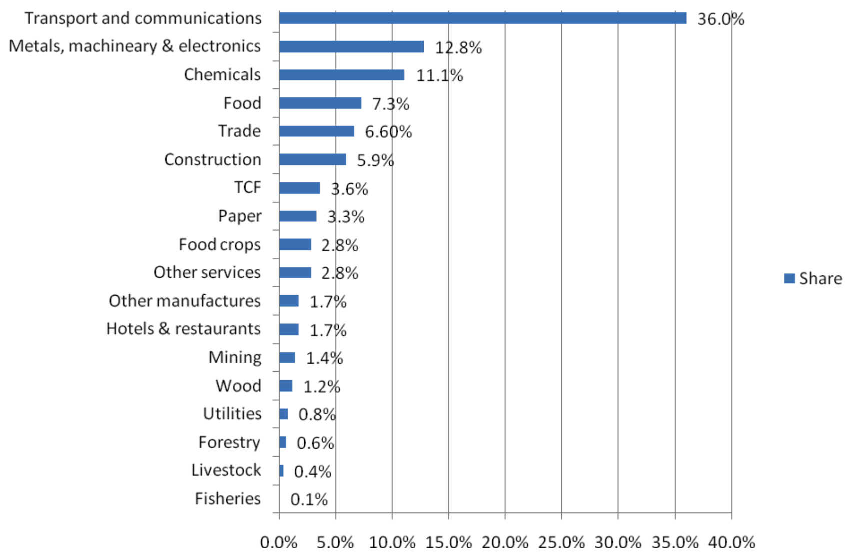
Table 4.2: EU countries' FDI in Indonesia, 2002–06 (USD million)

EU countries	2002	2003	2004	2005	2006	Average share (%)*
Austria	0	4	0	0	1	0.1
Netherlands	520	282	199	921	35	33.0
Belgium	1	32	79	7	1	2.0
Denmark	7	0	0	0	1	0.1
Finland	3	0	0	0	1	0.1
UK	206	517	298	1,293	661	50.2
Italy	1	1	1	1	2	0.1
Germany	170	54	125	19	15	6.5
Luxembourg	1	3	0	8	0	0.2
France	7	158	160	10	105	7.4
Spain	1	1	1	8	0	0.2
Sweden	0	5	0	1	0	0.1
Greece	0	0	0	1	0	0.0
Total	918	1,057	862	2,268	821	100

* This column does not total exactly 100 due to rounding.

Source: BKPM (2007)

Figure 4.4: EU share of direct investment in Indonesia by industry, 2002–06 (%)



TCF = textiles, clothing and footware.

Source: BKPM (2007)

Table 4.3: EU FDI in Indonesia by industry, 2002–06 (USD million)

	2002	2003	2004	2005	2006	Average share (%)*
Food crops	3	43	30	44	48	2.8
Livestock	2	0	4	13	3	0.4
Forestry	0	0	0	30	4	0.6
Fisheries	0	0	1	1	5	0.1
Mining	25	6	23	15	14	1.4
Food	65	62	108	152	47	7.3
TCF	52	31	33	30	65	3.6
Wood	6	31	1	23	8	1.2
Paper	8	2	78	3	103	3.2
Chemicals	157	113	96	252	160	12.8
Metals, machinery and electronics	138	113	96	252	160	12.8
Other manufactures	9	11	19	46	16	1.7
Utilities	0	15	1	17	14	0.8
Construction	4	21	72	235	20	5.9
Trade	48	60	126	97	60	6.6
Hotels and restaurants	5	16	17	46	15	1.7
Transport and communications	378	578	101	894	184	36.0
Other services	17	15	37	76	20	2.8
Total	918	1,057	862	2,268	821	100

* This column does not total exactly 100 due to rounding.

Source: BKPM (2007)

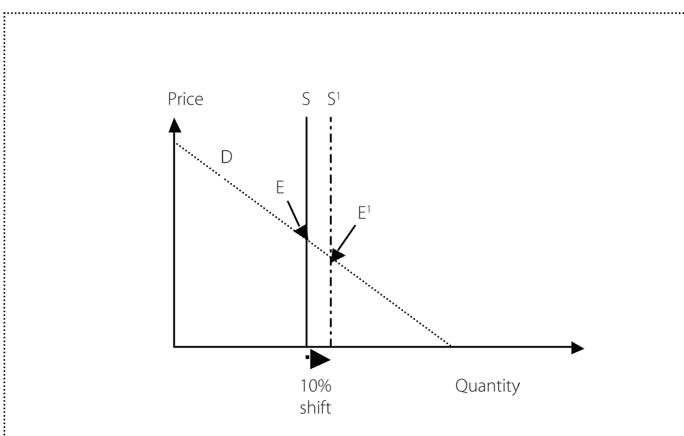
Scenario 1: The expansion of EU investment in Indonesia by 10 percent

Shock

Under the first scenario, we simulate what can be expected if EU investment in Indonesia grows by 10 percent. The AEUFTA is expected to make Indonesia a more attractive location for investors from the EU, which should in turn encourage capital to flow from the EU to Indonesia (refer to Figure 4.5). The short run closure is utilized in this scenario. From the perspective of income, it is assumed that national employment is flexible relative to the base case, while the average real wage is fixed. In the short run, only labour is able to move freely between industries and regions, while capital stocks remain exogenous. Investment in all regions and industries is linked to capital rentals. On the expenditure side, it is assumed that aggregate consumption is linked to nominal GDP via a consumption function, while government consumption is fixed. At the industry level, the investment to capital ratio is fixed, while the trade balance as share of GDP is assumed to be exogenous, and real wage is indexed to the regional consumer price index (CPI). A detailed closure is explained in Appendix 3. This scenario simulates capital growth in Indonesia with different rates, each representing a 10 percent growth of investment in industries that are nominated by EU investors in Indonesia (see Table 4.9 and Appendix 4). Bear in mind that in this model, the capital moves with the investment. Consequently, the growth of capital can also be equated with the growth of investment.

Figure 4.5 illustrates the interaction between demand for and supply of capital in an industry caused by new capital inflows. We assume that capital in the short run is a completely inelastic supply and at flexible rates of return. We shocked the model by shifting the supply curve for capital by 10 percent to the right vertically.[74] The initial equilibrium is at point E. The shock moves the supply curve vertically to the right from S to S'. As a result, the equilibrium moves from point E to E', which has a lower price and higher quantity of capital. We apply a list of shocks simultaneously by industry for all capital with different rates, each representing a 10 percent growth in EU capital in Indonesia. For example, a national capital growth of 2 percent is applied to the transport and communications industry, representing a 10 percent growth in capital inflows only from the EU to Indonesia (refer to Table 4.9, column 3).

Figure 4.5: Interaction between demand for and supply of capital in the short run



74 The AEUFTA would make Indonesia more attractive for EU investors, hence, demand for capital would have increased. In this experiment, capital inflows grow by 10 percent.

Simulation results of scenario 1

Table 4.4 shows the effect of the 10 percent increase in EU capital inflows to Indonesia. In most cases, the simulation results are presented in percentage change from the base case. In order to simplify our discussion, we first discuss the macro variables, followed by the sectoral variables.

Table 4.4: National real macroeconomic impacts of capital inflows from the EU to Indonesia (% change from base case)

Macro results	% change
Household expenditure	-0.11
Real investment expenditure	0.99
Real government expenditure	0.00
Export volumes	2.65
Import volumes	-0.23
Real GDP	1.16
Aggregate employment	0.89
Average real wage	0.00
Aggregate capital stock	1.53
GDP price index	-1.06
CPI	-0.95
Export price index	-0.52
Import price index	0.00

Macro results

Since the real wage is fixed in the short run, nominal wages move along with the decrease of 0.95 percent in the CPI. The fall in capital rentals results in an increase in capital stock by 1.53 percent, which represents the average shocks applied to the model (refer to Appendix 4 for the list of shocks applied in this simulation). This, in turn, encourages investment to rise by about 0.99 percent. More capital inflows from the EU, however, will cause capital rental to fall. The price ratio of export price index to import price index improves the terms of trade. In other words, the price of exports becomes relatively cheaper than the price of imports. The existing simulation also involves an increase of capital (K). With the absence of technological change, the terms of trade improve, while the real wage is fixed. With the improvement of the terms of trade by 0.52 percent (or where the price of exports falls by 0.52 percent and the price of imports is fixed), an increase in the aggregate capital (K) by 1.53 percent implies an increase in aggregate employment (L) by less than 1.53 percent. Consequently, the K:L ratio is expected to rise. In keeping with our expectations, aggregate employment also grows by 0.89 percent.

Since industrial investment is modelled as moving with capital by industry, what is the reason for the difference in the growth rates of aggregate capital and aggregate investment? Aggregate capital stock and aggregate investment are share weighted sums of industry capital stocks and industry investment, although the weights of the two are different. Whereas capital stock weights are used for aggregate capital stock, investment weights are used for aggregate investment. Meanwhile, on the production side of GDP, capital grows by 1.53 percent, while employment grows by less than the capital growth, or 0.89 percent. New capital inflows from the EU are expected to cause capital rentals to fall, and industries are thus more likely to favour capital than labour. Increases in capital and labour induce real GDP to grow by 1.16 percent. On the expenditure side, real household expenditure decreases by 0.11 percent, following the household modified income (refer to Appendix 3). The fall in household income emerges as a result of the reduction in the earnings from the pre-existing capital. It is implicitly assumed that all this pre-existing capital originally belonged to Indonesian residents, while much of the new capital is owned by investors from the EU. In this simulation, household consumption equals the welfare of Indonesian people. Consequently, when a fall in household consumption emerges in this simulation, it also indicates a significant decline in the welfare of Indonesian people. Therefore, a 10 percent increase in capital inflows from the EU could see a decline of 0.11 percent in the welfare of Indonesian people.

The decrease in capital rental induces lower industry costs, which subsequently makes the GDP price index fall by 1.06 percent and the export price index by 0.52 percent. Bear in mind that the fall in the export price index also reflects stiffer international competition—a situation that forces the export volume of Indonesia to foreign countries to grow by 2.65 percent. Despite an expansion in economic activity, import volumes in Indonesia fall by 0.23 percent, which is mainly due to the replacement of imported products with domestically produced goods.

Sectoral results

Outputs in trade exposed industries grow faster than those in less trade exposed industries. In the short run closure, where the average real wage is fixed, new capital from the EU can be expected to cause capital to become less scarce, which forces a decrease in capital rental in order to reduce domestic cost. Under these conditions, output prices and export prices are likely to decrease. Trade exposed sectors grow significantly more than non-trade exposed sectors. Trade exposed sectors become more internationally competitive as their prices fall, so expand more than non-trade exposed sectors. Sectors such as metals, machinery and electronics expand the most, by around 1.96 percent, because these sectors are not only the trade exposed sectors that gain mostly from export, but are also in high demand among investors. It is important to note that investors spend an average of 24 percent of their expenditure on metals, machinery and electronics.

Table 4.5: Sectoral impacts of EU capital inflows to Indonesia (% change from base case)

Sectors	Employment (1)	Export (2)	Output (3)	Output price (4)
Food crops	0.71	4.48	0.63	-0.76
Plantations	1.74	0.45	1.12	0.10
Livestock	0.50	6.85	0.76	-1.28
Forestry	1.84	0.60	1.08	0.30
Fisheries	0.66	6.31	0.78	-1.12
Mining	1.59	0.15	0.98	0.01
Food	0.85	6.22	1.10	-1.07
TCF	1.99	2.62	1.63	-0.42
Wood	1.84	2.13	1.37	-0.31
Paper	1.46	1.51	0.97	-0.23
Chemicals	1.66	3.30	1.72	-0.53
Petrol refineries	2.03	1.18	1.64	-0.33
Liquid natural gas (LNG)	1.86	1.67	1.67	-0.33
Metals, machinery and electronics	2.40	2.49	1.96	-0.33
Other manufactures	1.90	4.1	1.98	-0.67
Utilities	-0.56	0.00	0.84	-1.79
Construction	0.46	0.00	0.99	-0.99
Trade	0.46	0.00	1.16	-1.94

Sectors	Employment (1)	Export (2)	Output (3)	Output price (4)
Hotels and restaurants	0.53	5.97	1.05	-1.51
Transport and communications	1.31	6.05	1.85	-1.51
Finance	1.48	5.67	1.61	-1.13
Government and defence	-0.06	5.64	0.02	-1.09
Education	-0.07	5.41	0.12	-1.06
Other services	0.34	5.81	0.83	-1.49

Expansion in less trade exposed and non-exportable sectors (e.g., utilities, construction and trade) is driven mostly by growing domestic economic activity (e.g., national investment grows by 0.99 percent) and the expansion of trade exposed sectors. As non-exportable sectors, the government and defence sectors, for instance, grow by only 0.02 percent. The same also applies to other non-exportable sectors, such as education and construction, where growth reaches a mere 0.12 percent and 0.99 percent, respectively. The expansion of these non-exportable sectors is mainly caused by the increase in investment. It is also interesting to note that around 72 percent of investors' expenditure goes on the construction sector. Other non-exportable commodities, such as utilities and trade, are not expected to either grow or decrease at all, despite the fact that outputs from these sectors expand as a result of increased domestic demand.

Similarly, employment in trade exposed industries grows much faster than in less trade exposed industries. The reason for the sectoral employment result is similar to the reason behind the sectoral output result. As labour income falls, industries that sell goods to households (e.g., food crops, livestock, utilities and education) experience a decline. Industries that sell to expanding industries (e.g., TCF, metals, machinery, electronics, chemicals, petrol refineries, LNG and mining) are likely to grow, while industries that use these products also do well. Meanwhile, trade-exposed industries that use more capital, such as petrol refineries, LNG, transport and communications, and finance are expected to grow more than industries that depend on a labour force.

Sectoral results by Indonesian province[75]

Table 4.6: Impacts of capital inflows from the EU to the LNG industry in Aceh and East Kalimantan (% change from base case)

	Aceh	East Kalimantan
Direct exports to the rest of the world	1.670	1.660
Industry output	1.670	1.660
Nominal wage	-0.940	-0.920
Employment	1.890	1.850
Capital rentals	-0.350	-0.410
Capital	1.590	1.590
Intermediate costs	-0.100	-0.050
Domestic prices	-0.330	-0.330
Export to other regions	0.001	-0.001
Import from other regions	-0.001	0.001
LNG made and used locally	1.675	1.664

75 In writing on Indonesia, it is not uncommon for authors to refer to the country's 'regions' when they in fact mean provinces. This is because the country is so large. However, since there is so much discussion of regions in terms of groupings of countries in this book (the EU, ASEAN, etc.), the term 'provinces' is used, for clarity.

While the previous subsection describes the macro sectoral impacts deriving from the expansion of EU investment in Indonesia, this subsection focuses on regional sectoral results. It is important to bear in mind that national results do not exceed the sum of the corresponding regional results. The LNG sector is chosen to illustrate the regional results. LNG is a capital intensive industry, with 40 percent of the total cost involving the capital cost, and is located mainly in the provinces of Aceh and East Kalimantan. LNG is mostly produced for export and Indonesia is currently one of the major exporters of LNG to the world. This sector also plays a significant role in the current relationship between the EU and Indonesia. The simulation suggests that as the cost of LNG decreases as a result of the decrease of capital cost (0.35 percent in Aceh and 0.41 percent in East Kalimantan), the price of domestic output is expected to decrease as well (0.33 percent in both provinces). In turn, exports of LNG expands (1.76 percent in Aceh and 1.66 percent in East Kalimantan). The increase in exports from both regions will play a significant role in increasing overall national export growth by around 1.67 percent (refer to Table 4.6).

Household expenditure in Indonesia's provinces

Figure 4.6: Real household expenditure by province (% change from base case)

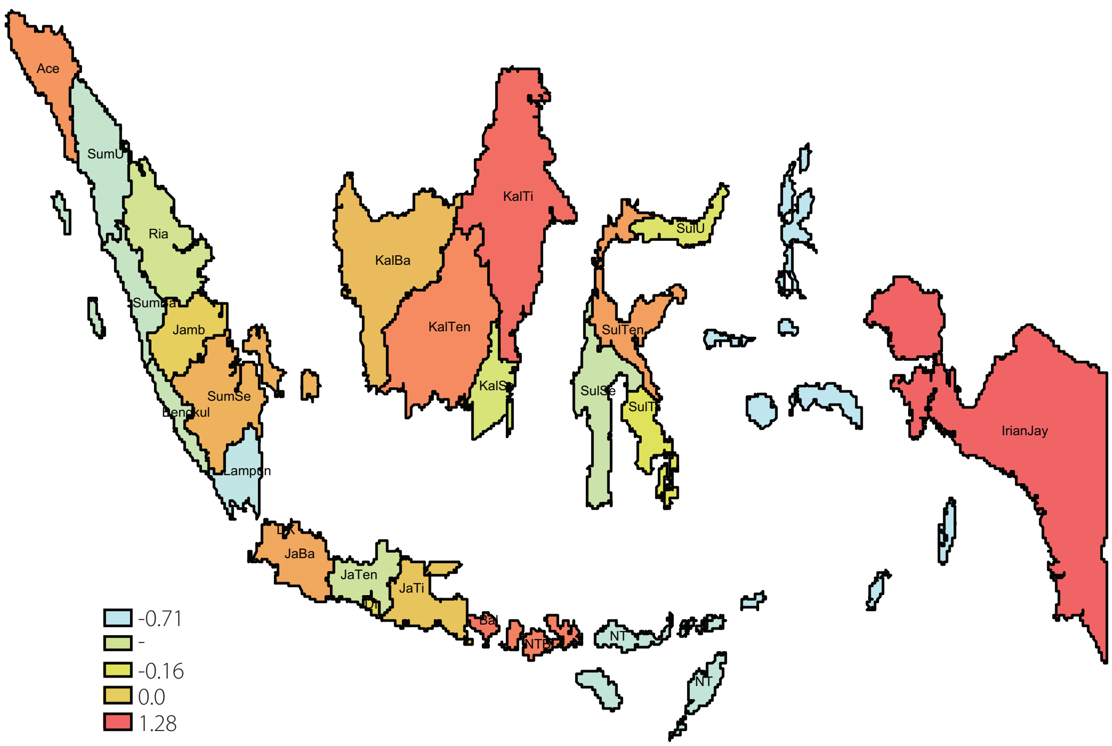
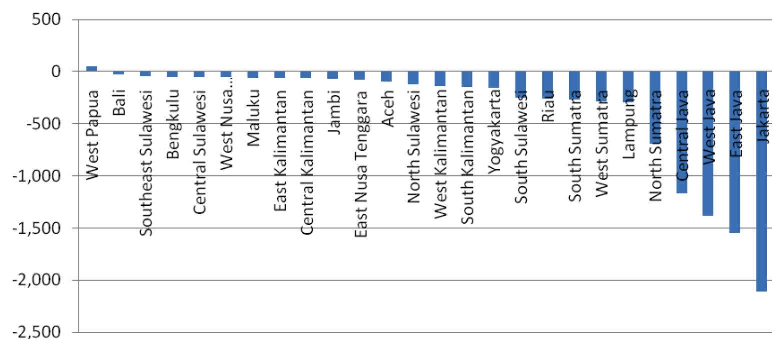


Figure 4.7: Ordinary changes in household expenditure by province, scenario 1 (IDR billion)



Paradoxically, this scenario leads to a decrease in local income levels. The decrease in rentals from the existing capital stock, which is to be assumed to be locally owned, and the decrease in wage income contribute significantly to a reduction in household income. This condition, in turn, generates significant falls in household expenditure in most regions by around 0.11 percent (refer to Figure 4.6). In some regions, however, such as West Java, Central Sulawesi, Aceh, Central Kalimantan, West Nusa Tenggara, Bali, East Kalimantan and West Papua, household expenditure grows significantly.

Based on the Indonesian Input-Output Tables for 2000 (Indonesian Bureau of Statistics, 2002), ordinary change of national household income falls by IDR 9,426 billion. Figure 4.7 illustrates the distribution of changes in household income by region. The data in this figure show that only West Papua gains by IDR 50 billion, while the other regions lose out. In this scenario, Jakarta is expected to experience the most significant loss from an expansion of EU investment in Indonesia, followed by East Java, West Java and North Sumatra. It is important to note that these are Indonesian's most densely populated provinces. Consequently, significant losses in these provinces can be expected to bring about major economic challenges to Indonesia as a whole.

Provinces' GDP expenditure

Figure 4.8: Ordinary changes in GDP expenditure by province, scenario 1 (IDR billion)

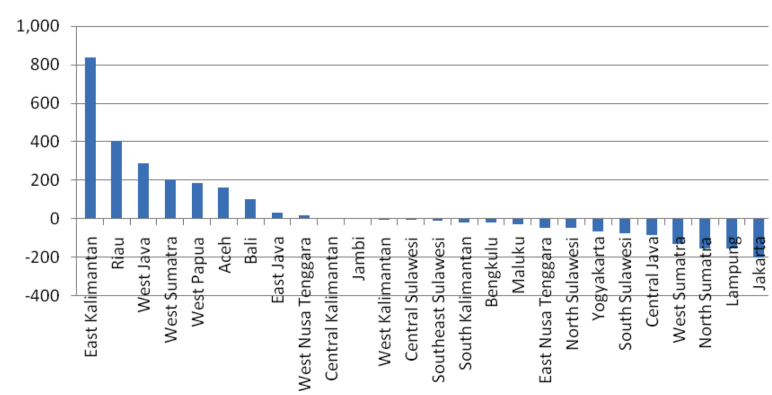


Figure 4.8 illustrates the results of GDP expenditure by province. National GDP grows by IDR 1,188 billion. In Scenario 1, East Kalimantan province is expected to be the major winner, with an increase in

GDP of IDR 836.6 billion, followed by Riau (IDR 403.1 billion), West Java (IDR 288.5 billion), South Sumatra (IDR 204.2 billion), West Papua (IDR 183.6 billion) and Aceh (IDR 163.4 billion). These provinces experience significant gains because they have a high share of national capital industries (86 percent of LNG, 18.7 percent of mining and 23 percent of petrol refineries). These industries attract the most investment from the EU.

Scenario 2: The growth of Indonesian exports to the EU by 18.5 percent

This section examines a simulation where Indonesian exports to the EU have grown by 18.5 percent. This figure derives mainly from the EU's commissioned study of the likely economic benefits of an AEUFTA by the Centre for Future Studies and International Information (CEPII) and the Centre for Information and Research on the Global Economy (CIREM) (CEPII-CIREM, 2006). The CEPI-CIREM study assesses an AEUFTA in terms of three different scenarios. In the first scenario, tariffs on goods are fully dismantled, while 50 percent of barriers on services are removed. In the second CEPII-CIREM scenario, a list of sensitive products is excluded under the AEUFTA. Finally, in the third scenario, the CEPII-CIREM team proposes an alternative pre-experiment scenario in order to assess the impact of a changing environment within the world economy. In the first scenario, the study speculates that ASEAN's exports to the EU will improve by 18.5 percent. In the present study, however, the share of Indonesian exports in the EU that is used in the shock list is calculated based on trade data from the Global Trade Analysis Project database. In order to follow this through, long run closure is utilized where capital is flexible and national employment is fixed. Labour movement is determined by the real wage differences between industries and regions (refer to Appendix 3). The application in this quantitative study consists of a list of export shocks, particularly the increase of Indonesian export commodities to the EU by 18.5 percent.

Macro results

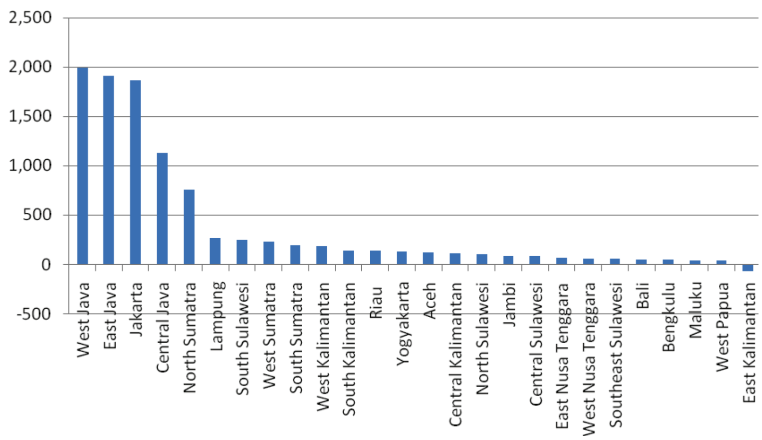
While the first scenario presented in this quantitative study suggests that capital inflows from the EU to Indonesia cause the income of Indonesian households to fall, under the second scenario an 18.5 percent growth in Indonesian exports to the EU generates a slight increase in household income. Despite the increase, the same scenario also causes a growth in household consumption of about 0.48 percent. At the same time, the Indonesian overall national export volume increases by 0.21 percent. At this point, it is also important to bear in mind that an estimate of 18.5 percent growth in Indonesian exports to the EU is in fact an exaggeration, as the latter's main trading partner in ASEAN is Singapore. In real terms, it is likely that the growth of Indonesian exports to the EU will be less than 18.5 percent.

Meanwhile, an increase of 0.48 percent in household consumption is caused mainly by an increase in real labour income of 0.50 percent. Since it is assumed that gross growth rates of capital are fixed, regional investment follows regional capital growth. In this context, aggregate capital stock grows by 0.07 percent, while national real investment, real GDP, export volumes and import volumes all grow by 0.16 percent, 0.03 percent, 0.21 percent and 1.30 percent, respectively. In comparison, another simulation exercise conducted by CEPII-CIREM suggests that ASEAN member countries are expected to gain significantly, adding up to more than 2 percent of total GDP in 2020. In general, however, our study notes that GDP is expected to grow by IDR 9.989 billion. This amount is distributed across Indonesian provinces, as illustrated in Figure 4.9. Most provinces are expected to gain, with West Java, followed by East Java, Jakarta and Central Java, expected to experience the most significant gains.

Table 4.7: National real macroeconomic impacts of export growth to the EU (% change from base case)

Macro results	% change
Real household expenditure	0.48
Real investment expenditure	0.16
Real government expenditure	0.00
Export volumes	0.21
Rest of the world import volume used	1.30
Rest of the world import volume landed	1.30
Real GDP	0.03
Aggregate employment	0.00
Average real wage	0.50
Aggregate capital stock	0.07
GDP price index	0.70
CPI	0.57
Export price index	0.49
Import price index	0.00

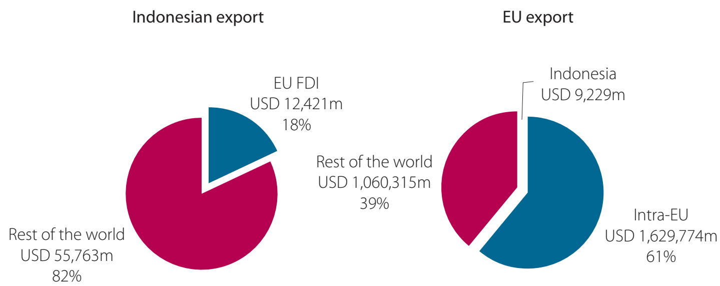
Figure 4.9: Ordinary changes in GDP expenditure by province, scenario 2 (IDR billion)



Since it is assumed that national aggregate employment is fixed, a 0.07 percent growth in capital generates a 0.03 percent growth in national GDP. Moreover, due to a domestic price increase (e.g., the increase in the price of GDP by 0.70 percent), the export price index is also expected to rise. In the meantime, due to the shocks, export volumes also grow by 0.21 percent, which generates an expansion in Indonesian economic activity (e.g., real GDP grows by 0.03 percent). Increased income leads to increased household expenditure, as well as more goods and services being imported from the EU. In this simulation, the import volumes from the rest of the world grow by 1.30 percent due to increased demand and the significant gains in market share for imports entering Indonesia.

Export results

Figure 4.10: Indonesian and EU export destinations, 2004



Source: CGTA(2006)

A simulated 18.5 percent increase in Indonesian exports to the EU causes national export volumes to grow by only 0.21 percent (refer to Table 4.7). This is mainly due to the fact that the share of Indonesian exports to the EU accounts only for only 18.2 percent of total Indonesian exports, worth about USD 12,421 million. In comparison, exports from the EU to Indonesia are worth USD 9,229 million, or 0.3 percent of total EU exports to the rest of the world (refer to Table 4.8 and Figure 4.10).

Table 4.8: Indonesian and EU export destinations, 2004

	Indonesia	EU	Rest of world	Total
		(USD million)		
Indonesia	0	12,421	55,763	68,184
EU	9,229	1,629,774	1,060,315	2,699,318
Rest of world	34,281	1,057,304	3,038,549	4,130,134
Total	43,510	2,699,499	4,154,627	6,897,636
		(%)		
Indonesia*	0.0	18.2	81.8	100
Intra-EU*	0.3	60.4	39.3	100
Rest of world*	0.8	25.6	73.6	100
Total world trade*	0.6	39.1	60.2	100

* These rows should be read independently of one another and figures in the 'Total world trade' row are not the sum of the preceding three rows in each column.

Source: CGTA (2006)

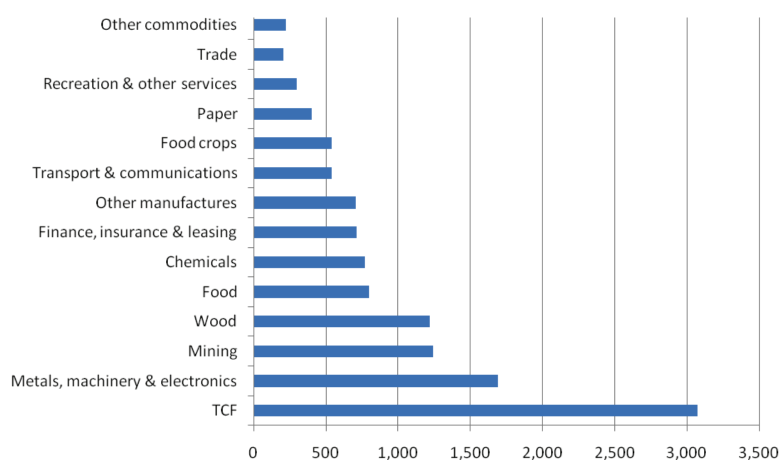
Although the present simulation shows an expansion in all exportable Indonesian commodities to the EU, export growth is only evident in food crops, plantations, livestock, food, TCF and wood. Among these exports, the TCF sector is likely to experience the most significant gains, at about 2.63 percent (refer to Table 4.9). Figure 4.11 also shows that the TCF sector contributes USD 3,075 million, which is about 24.8 percent of total Indonesian exports to the EU and 30 percent of total Indonesian TCF exports to the world. Utilities, construction and trade commodities exports remain the same because they are mostly non-exportable commodities, and thus no shocks are applied to these sectors. Despite this, the simulation shows that the output of these non-exportable sectors expands, mainly due to increased demand from the domestic market.

Table 4.9: Indonesia's national real sectoral impacts of export growth to the EU (% change from base case)

	Employment (1)	Export (2)	Output price (3)	Output
Food crops	0.057	0.420	0.859	0.160
Plantations	0.332	2,804	0.959	0.360
Livestock	0.191	2.004	0.817	0.249
Forestry	0.031	-3.179	0.763	0.118
Fisheries	-0.058	-2.934	0.769	0.066
Mining	-0.752	-0.654	0.254	-0.358
Food	0.132	1.879	0.710	0.353
TCF	1.395	2.636	0.550	1.597
Wood	0.005	0.178	0.588	0.220
Paper	-0.358	-0.472	0.446	0.127
Chemicals	-0.181	-0.457	0.433	0.013
Petrol refineries	-1.881	-0.689	0.359	-1.657
LNG	-0.847	-0.766	0.387	-0.766
Metals, machinery and electronics	-0.256	0.296	0.455	-0.034
Other manufactures	-0.257	-0.346	0.565	-0.038
Utilities	-0.163	0	0.501	0.369
Construction	0.004	0	0.554	0.145
Trade	0.157	0	0.691	0.313
Hotels and restaurants	-0.066	-3.278	0.743	0.047
Transport and communications	-0.242	-2.497	0.539	-0.026
Finance	-0.402	-2.912	0.592	-0.183
Government and defence	0.036	-4.874	1.001	0.051
Education	0.253	-4.018	0.824	0.284
Other services	0.086	-3.060	0.718	0.203

Finally, due to stiff competition from overseas industries and among different industries in Indonesia, exports of the following commodities lose their market shares: forestry, fisheries, paper, chemicals, petrol refineries, LNG, other manufactures, hotels and restaurants, transport and communications, finance, government and defence, education, and other services. These sectors lose simply because they become more expensive, as shown by the increase in export prices (the national export price index grows by 0.49 percent).

Figure 4.11: Indonesian exports to the EU by commodity, 2004 (USD million)



Sectoral output and employment

For trade exposed industries, an increase in industry costs (e.g., wages) leads to a loss of market share, which causes output and employment to shrink (refer to Table 4.9). This occurs mainly in the mining; paper; petrol refineries; LNG; metals, machinery and electronics; other manufactures; transport and communications; and finance industries. On the other hand, industries that are less exposed to competition can be expected to grow. For example, utilities grow by 0.37 percent, construction by 0.15 percent and trade by 0.31 percent. Since local goods are produced and consumed locally, demand for local goods grows to follow the absorption, which is mainly driven by labour income. Since the input costs of firms increase, output prices can also be expected to increase in all sectors. Industries that are experiencing a growth period also tend to hire more workers, except in the fisheries, chemicals, and hotels and restaurants industries.

Moreover, the expansion of exports also causes output to expand. The demand for industry inputs thus grows and causes industry costs to increase. In the TCF industry, for example, export grows by 2.64 percent due to the shock that generates an expansion of 0.55 percent in the output of this industry. The expansion of the TCF industry also causes the demand for inputs to expand. This, in turn, leads to an increase in industry costs. The TCF sector's costs are mainly associated with labour, capital and intermediate inputs. The cost increases are indicated by an increase of 0.55 percent in domestic prices (refer to Table 4.9).

In some trade exposed sectors, such as food crops, plantations, livestock and forestry, employment can also be expected to grow, although this is not the case for many other trade exposed sectors, such as fisheries, mining and paper. In the latter sectors, export expansion is not enough to counteract an increase in domestic costs. Therefore, despite an expansion of Indonesian exports to the EU, these industries can be expected to suffer significant losses as their output shrinks. This is particularly true of the mining, petrol refineries and LNG sectors. The chemicals industry, however, is an exception. In this sector, output does grow, but by a mere 0.01 percent. Employment in the chemicals industry still falls by about 0.18 percent as a result of the significant increase in capital costs. This condition allows for industry to utilize more labour than capital, demonstrating that a change in existing trade policy (e.g., the introduction of an AEUFTA) will lead to both gains and losses.

Summary of results

Table 4.10: Summary of simulated AEUFTA impacts on the Indonesian economy (%)

Closure scenario	EU capital inflows to Indonesia grow by 10% (short run)	Indonesian exports to the EU grow by 18.5% (long run)
Household expenditure	-0.11	0.48
Real investment expenditure	0.99	0.16
Real government expenditure	0.00	0.00
Export volumes	2.65	0.21
Import volumes	-0.23	1.30
Real GDP	1.16	0.03
Aggregate employment	0.89	0.00
Average real wage	0.00	0.50
Aggregate capital stock	1.53	0.07
GDP price index	-1.06	0.70
CPI	-0.95	0.57
Export price index	-0.52	0.49
Import price index	0.00	0.00

In order to analyze the possible economic impact of an AEUFTA on Indonesia, this study uses EMERALD, a CGE model made specific for Indonesia. Two scenarios are introduced: (1) the expansion of EU investment in Indonesia by 10 percent; and (2) the growth of Indonesian exports to the EU by 18.5 percent. Table 4.10 summarizes the simulation results. In the first scenario, the short run closure simulation shows that capital inflows from the EU impact negatively on the welfare of Indonesian household as a whole. This is due mainly to a fall in household income. The quantitative simulation results presented in this chapter also suggest that Indonesian household expenditure or consumption will fall by 0.11 percent as a result of EU capital inflows. Any employment growth in Indonesia would not counteract the overall profit loss to Indonesians. Similarly, increased EU investment in Indonesia does not mean increased Indonesian exports to the EU. Despite this, in the first scenario, real investment grows by 0.99 percent, while exports fall by 2.65 percent and imports grow by 0.23 percent. The Indonesian economy as a whole can be expected to experience a slight gain from capital inflows from the EU (e.g., national GDP, employment and capital grow by 1.16 percent, 0.89 percent and 1.53 percent, respectively).

In the second scenario, a growth of 18.5 percent in Indonesian exports to the EU leads to a rise in real investment by 0.16 percent. The long run effect of this export growth would be that Indonesian labour increases its production capacity, while real wages increase by 0.50 percent. This leads to an increase in Indonesian household income. It is important to bear in mind, however, that an assumed 18.5 percent expansion in Indonesian exports to the EU is somewhat exaggerated, as it is unlikely that they will grow this much. With regard to the sectoral level, although export growth to the EU increases household welfare in the long run, such conditions contribute little to national GDP. Nonetheless, the results in the second scenario are much better than in the first.

Chapter 5 – The Perspectives of Different Actors in Indonesia, ASEAN and the EU on the ASEAN–EU Free Trade Agreement

Introduction

A number of qualitative studies have already been carried out on the proposed AEUFTA, many of which have failed to fully include the perspectives of key state and non-state actors from both regions on this trade agreement. Prior to the announcement of the AEUFTA negotiations in mid-2007, however, the DGTEC commissioned the Consortium of Euro-Asia Centre, University of Limerick, Ireland, and the French Institute for International Relations to carry out a qualitative study on the proposed AEUFTA (Consortium of Euro-Asia Centre and IFRI, 2006).[76] Apart from its analysis of trade and investment relations between the two regions, this EU study also presented the opinions of a range of socioeconomic actors in both ASEAN and the EU regarding the AEUFTA.[77]

Although the European Commission's study presents insights into the aspirations of various actors in both regions regarding the AEUFTA, the study is Eurocentric and biased towards the business community. It concentrates mainly on the aspirations of economic players, particularly business corporations and associations. Among the 89 respondents targeted to complete the questionnaire used by the European Commission, about half represented the business sector, while a further quarter comprised government officials. The opinions of wider civil society groups, such as NGOs, trade unions and grassroots organizations, are largely omitted from this study. Only two ASEAN-based NGOs were targeted in the research process: one from the Philippines and the other from Lao PDR. In contrast, the authors of the present book have carried out a qualitative analysis that not only complements the European Commission's study, but also seeks to provide a wider and thus more balanced range of views on the subject in hand.

This chapter analyzes the prevalent perspectives of key actors in the EU, ASEAN and Indonesia on the possible negotiation and implementation of the AEUFTA. Prior to this analysis, the chapter will examine the existing case for and against the AEUFTA. The chapter then moves on to examine perspectives on (1) ASEAN–EU economic relations; (2) developmental aspects of the AEUFTA; (3) trade and investment aspects of the AEUFTA; and (4) the trade policymaking process of the AEUFTA. The chapter ends with an overall assessment of the perspectives of key actors in the EU, ASEAN and Indonesia on the proposed AEUFTA.

The case for and against the AEUFTA

Prior to highlighting the case for and against the AEUFTA, one should perhaps ask why such a trade agreement is necessary. Apart from the more obvious commercial motives, BFTAs are also established to advance the political objectives of participating countries. The AEUFTA is no exception.

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76 The European Commission also commissioned the Centre for Future Studies and International Information (CEPII) and the Centre for Information and Research on the Global Economy (CIREM) to carry out a quantitative feasibility study on the AEUFTA. For further details of this study, see CEPII-CIREM (2006).

77 See, in particular, Consortium of Euro-Asia Centre and IFRI (2006, chap. 8).

As noted in Chapter 2 of this study, ASEAN first proposed this trade agreement with the EU. For the member countries of ASEAN, an AEUFTA not only offers wider access to the EU market, but also provides an opportunity to raise ASEAN's profile in the field of international diplomacy. The EU's increasing influence on the global economy certainly plays a significant role in prompting ASEAN to establish an AEUFTA with Europe. Many ASEAN policymakers see access to Brussels' political and economic agenda as important. On the political front, the AEUFTA will perhaps draw the EU's attention to Southeast Asia. It is also hoped that the AEUFTA will act as a counterpoint to the increasingly aggressive economic agendas of the U.S. and China in the Southeast Asian region. Because ASEAN economies are vulnerable, policymakers feel obliged to engage with major global economic powers. It is only with the EU that ASEAN has failed so far to set up an FTA initiative.

The EU has at least three broad motives for establishing the AEUFTA. Firstly, it would serve the EU's commercial objectives. The AEUFTA will not only neutralize the potential trade diversion effect that results from enhanced economic integration in the EU region, but will also allow the EU to forge strategic links with the rapidly growing economies of ASEAN (Woolcock, 2007). Like many other developed countries, the EU is interested in better enforcing international trading rules through such agreements, particularly in light of the recent lack of progress in WTO global trade talks. Secondly, Europe hopes that any resulting economic growth and development in the ASEAN region will bring about political transformation in the most oppressive regimes there, particularly that of Myanmar. Finally, the EU also wants to promote a European model of integration in the Southeast Asian region. The AEUFTA should complement the EU's existing APRIS, which promotes regional integration in Southeast Asia. The AEUFTA is intended to act as an external pressure on ASEAN to work collectively.

So what are the benefits and costs of an AEUFTA for ASEAN and the EU? To date, most existing cost benefit analyses of the AEUFTA have been produced by mainstream intellectuals and academic think tanks, many of whom favour neoliberal trade and investment liberalization. The European Commission's quantitative study of the AEUFTA, which was carried out by CEPII-CIREM (2006), for instance, suggests that an AEUFTA would generate significant economic benefits for both ASEAN and the EU. The CEPII-CIREM study proposes three different scenarios in which an AEUFTA can be implemented: (1) tariffs on goods are fully dismantled, while 50 percent of barriers in the services sectors are removed; (2) lists of sensitive products are excluded from the agreement; and (3) an alternative pre-experiment scenario is used whereby two other FTAs are assumed to take place at the same time as the AEUFTA (the first between ASEAN and all other industrialized countries except the EU-25, and the other between the EU-25 and Mercosur). The CEPII-CIREM study found, firstly, that ASEAN's gains are significantly large, adding up to more than 2 percent of GDP in 2020. Secondly, three quarters of those gains are associated with benefits generated through services sector liberalization. Thirdly, ASEAN and the EU would gain even if a list of sensitive products were included in the agreement. Fourthly, the agreement would be more desirable if the EU managed to establish a BFTA with Mercosur, while ASEAN fully implements BFTAs with Japan and the U.S. At the macro level, the CEPII-CIREM study also suggests that the AEUFTA will increase EU exports to ASEAN by 24.2 percent and ASEAN exports to the EU by 18.5 percent.

The DGTEC (2007) has issued a memo highlighting the main findings of the EU's commissioned feasibility studies on the AEUFTA, the EU–India FTA and the South Korea–EU FTA. These studies suggest that the three agreements should boost EU exports to ASEAN by 24.2 percent, to India by 56.8 percent and to South Korea by 47.8 percent. They should also increase total EU exports by 3.23 percent and increase the EU's GDP by 0.13 percent. The EU can expect to see an increase of 18.5 percent in exports from ASEAN, 18.7 percent in exports from India, and a 40 percent increase in benefits from the successful conclusion of the Doha Round negotiations. The memo also states that the largest gains for the EU in terms of the AEUFTA are in business services, where there could be an increase of 29 percent (worth EUR 7.9 billion). ASEAN's largest gains also lie in this sector, where there could be an 80 percent increase (worth EUR 14 billion).

Many critical studies on the AEUFTA, as well as on EU led BFTAs and/or EPAs, argue differently, however. Prof. Alfredo Robles (2007) of De La Salle University in the Philippines, for example, points to 'the false promises of an ASEAN–EU FTA'. Who, asks Robles, will be accountable if the estimates of the European Commission turn out to be inaccurate? Who is to compensate the ASEAN countries if after the AEUFTA comes into force some of them still experience a trade deficit vis-à-vis the EU? Is the AEUFTA to be suspended or annulled if ASEAN's trade balance fails to improve? Would all the unemployed in the industrial sector be able to find new jobs in the services sector? What is the estimated loss in tariff revenues associated with the establishment of an FTA? Other studies, such as the one conducted by Bilal and Rampa (2006), also question the estimations of the European Commission's feasibility studies. Quantitative impact studies are unreliable because of methodological constraints and the limited availability of data, which is particularly true of studies that examine least developed and/or developing countries. In their analysis of the assessment made by the European Commission on the EPA between the EU and the ACP countries, for instance, Bilal and Rampa (2006: 35) observe that the productive sector has been totally ignored, because data on it is not readily available in ACP countries. This is also true of Southeast Asian countries. In an analysis of the economic impacts of the ASEAN–China FTA on the Indonesian economy, Pambudi and Chandra (2006: 34) observe that the lack of trade and economic data often misleads policymakers in ASEAN, so BFTA assessments should therefore include qualitative investigations of specific economic sectors.

Perspectives on the proposed AEUFTA

Research interview methodology

As with the qualitative study commissioned by the European Commission, the present research study also collated the opinions of various state and non-state actors at the national and regional levels. This fieldwork was carried out between May and July 2007 in Brussels and Jakarta. While the EU respondents were mainly regional actors, the Jakarta respondents were both national and regional actors. The authors selected the current study's target respondents very carefully. The 22 respondents were equally distributed across different categories, i.e., officials of the regional institutions (i.e., the ASEAN Secretariat, the European Commission, European political parties); regional non-state actors (i.e., European business associations); Indonesian government officials (i.e., from the Ministries of Foreign Affairs; Trade; and Agriculture); and Indonesian non-state actors (i.e., business associations, the academic community and NGOs). Foreign representatives in Indonesia from, for example, the Royal Embassy of Thailand; the Malaysian Embassy; and the Delegation of the European Commission (EC Delegation) to the RI, Brunei Darussalam and Timor Leste also participated in the field research process.

Respondents in both regions were given a set of questions that covered four main areas, including (1) economic relations between ASEAN and the EU; (2) developmental aspects of the AEUFTA; (3) trade and investment under the AEUFTA; and (4) policymaking processes vis-à-vis the AEUFTA. The authors distributed the questionnaire by electronic mail to respondents in Jakarta and Brussels. The Jakarta respondents also received printed questionnaires. The respondents provided brief answers to about 13 general questions, depending on their areas of expertise. The number and nature of the questions varied for each actor.

Some respondents preferred a face-to-face interview to filling in a questionnaire. In situations where the targeted respondents were unable either to fill in the questionnaire or attend a face-to-face interview, the authors sought to find out the relevant institutions' official position from their respective websites. This was the case with some business associations and NGOs in Europe.

On ASEAN–EU economic relations

Bureaucratic and civil society groups in ASEAN and Indonesia

As a regional organization that has adopted the principle of open regionalism, ASEAN and its member countries regard relations with the EU, as with other established and emerging economic powers, as highly important. For ASEAN, the move towards BFTAs has not only been triggered by the desire for greater integration in the Asian region (i.e., through engagement with China, South Korea, Japan, India, Australia and New Zealand), but also by the recent setbacks in the WTO process. A representative of the ASEAN Secretariat stated that it was in the interests of member countries that ASEAN should continue to improve its economic relations with key dialogue partners.[78] This respondent added that the China factor also played a significant part in triggering BFTA initiatives between ASEAN and its key dialogue partners. The ASEAN–China FTA has forced other ASEAN partners to follow suit. This respondent also stated that the EU wants to establish a BFTA with ASEAN because of ASEAN's strategic importance, while ASEAN members see an AEUFTA as part of their commitment to trade liberalization in general.

Two representatives from Malaysia and Thailand echoed the views of the ASEAN Secretariat respondent in this regard,[79] i.e., improving economic relations between ASEAN and the EU is extremely important for ASEAN as an association. The Thai Embassy representative noted that the EU was one of ASEAN's key trading partners and that Europe was an important market for Southeast Asian products. The expansion of the EU in recent years also gave additional impetus to ASEAN to engage more deeply with the EU, especially on economic terms. The addition of new members to the EU is expected to significantly increase the trade volume between it and ASEAN. The Thai Embassy representative also stated that this economic relationship was important for ASEAN's newer members, the CLMV countries. Improved relations between ASEAN and the EU will, it is hoped, assist their economic development.

Similarly, the Indonesian government perceived regional and interregional cooperation as an extension of national interests. A representative of the Indonesian Ministry of Foreign Affairs (Departemen Luar Negeri, or Deplu) stated that improved ASEAN–EU relations are important for ASEAN, particularly in relation to its objective of establishing the ASEAN Community by 2015.[80] It is expected that the EU will be one of ASEAN's key partners in the area of development. The EU also has a wealth of experience in dealing with regional integration issues. Through enhanced partnership with the EU, ASEAN hopes to learn much about regional integration. The Deplu representative commented on the importance of ASEAN–EU trade relations, stating that stronger trade relations would improve economic growth in both regions. ASEAN member countries are particularly keen to gain wider market access to the EU and would like to secure more investment from European businesses operating in Southeast Asia.

78 Interview with Rony Soerakoesoemah, senior resource officer for the FTAs Unit, Bureau for Economic Integration and Finance, ASEAN Secretariat, Jakarta, 24 July 2007.

79 Based on a telephone interview with a member of the Trade Section of the Royal Embassy of Thailand, and a face-to-face interview with Mohammed Razak, economic counsellor, Commercial Section, Embassy of Malaysia, Jakarta, 22 June 2007 and 27 June 2007, respectively.

80 Interview with Achsanul Habib, first secretary, Directorate of ASEAN Political and Security Cooperation, Deplu, Jakarta, 17 July 2007.

A representative of the Indonesian Ministry of Agriculture (Departemen Pertanian, or Deptan) highlighted recent key figures on trade between the two regions.[81] In 2005, for instance, the EU was ASEAN's third largest trading partner. Total trade between the two regions reached USD 115.8 billion (EU exports to ASEAN amounted to USD 70.81 billion, while EU imports from ASEAN were USD 44.97 billion). As far as Indonesia is concerned, the EU has proven to be a very important trading partner. In 2005, for example, the EU was Indonesia's third largest trading partner, with a total trade of USD 12.95 billion.

The majority of non-state actors in Indonesia thought that economic relations between ASEAN and the EU, as well as between Indonesia and the EU, were relatively important for a number of different reasons. Opinions differed not only among members of the academic community who took part in the study, but also among NGO representatives. For example, Dr Djisman Simanjuntak stated that as far as trade and investment are concerned, ASEAN occupied a kind of triangular megastructure that forced it to engage with other countries and regions throughout the world.[82] Regional trade arrangements in Southeast Asia should thus never lose sight of the global context and should be consistent with global trade rules. Although the rise of China slightly jeopardizes the importance of the EU for ASEAN, Europe remains a key strategic economic partner. As for the EU, the importance of ASEAN has been redefined since the former expanded eastward. For Simanjuntak, the fear of *being left out* of the BFTA phenomenon was impetus enough for both ASEAN and the EU to establish an AEUFTA. A BFTA between the EU and Mercosur, for example, is likely to negatively impact on ASEAN's products in both regions, particularly if there are no similar trade agreements between ASEAN and the EU and between ASEAN and Mercosur. Agus Sardjono of the University of Indonesia felt that opinions about the relative importance of ASEAN–EU relations differed from group to group.[83] While large economic actors in the region might rate the relative importance of ASEAN–EU economic relations as high, the majority of Indonesians and members of the wider ASEAN community might place little importance on the economic partnership between the two regions.

For their part, NGO activists participating in the questionnaire/interview process viewed ASEAN–EU economic relations as relatively important. The majority of their feedback concentrated on the relevance of the AEUFTA to trade liberalization. Representatives from the Indonesian agricultural NGO Bina Desa and the International NGO Forum on Indonesian Development (INFID) agreed that ASEAN–EU economic relations were important because they could influence other forms of diplomatic and economic engagement that ASEAN pursues with other dialogue partners.[84] Other NGOs, such as the People's Coalition for Water Rights (Koalisi Rakyat untuk Hak atas Air, or KRuHA), also see the relation between ASEAN and the EU as important, particularly with regard to the privatization of water in the region. Many EU member countries have supported this process.[85] Despite some positive feedback about the enhancement of ASEAN–EU relations, most Indonesian activists were reserved about a BFTA policy with the EU. For them, the key question was how ASEAN would acquire equal bargaining power to the EU in the AEUFTA negotiations.

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81 Interview with Rismansyah, director, Directorate General of International Marketing, Deptan, Jakarta, 12 June 2007.

82 Interview with Dr Djisman Simanjuntak, at the time senior staff member at the Centre for Strategic and International Studies (CSIS) and board member of the Prasetya Mulya, Jakarta, 27 June 2007. Simanjuntak still has close ties with the CSIS and is a former member of the Expert Group for the AEUFTA.

83 Interview with Agus Sardjono, lecturer, Faculty of Law, University of Indonesia, Jakarta, 22 June 2007.

84 Interviews with Dwi Astuti, operational director, Bina Desa, and Nadia Hadad, programme officer, INFID, Jakarta, 17 June 2007 and 20 June 2007, respectively.

85 Interview with Hamong Santoso, co-ordinator, KRuHA, Jakarta, 6 July 2007.

Bureaucratic and civil society groups in the EU

Regional and state actors in the EU also see ASEAN–EU economic relations as relatively important. For the EU, however, the issue of ASEAN's own regional integration is as important as its economic interest in Southeast Asia. According to a representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste, the EU sees ASEAN as a similar kind of organization, particularly with regard to the push towards economic integration.[86] The EU is interested in sharing its experiences in order to help ASEAN establish the ASEAN Community by 2015. At the time of this interview, the EU was planning to extend its technical assistance to Indonesia and to cooperate with ASEAN through dialogue, technical assistance and in other ways. The EU's interest in forging a BFTA with ASEAN goes beyond economic and political reasons, and there are many dimensions to the partnership. In other words, the motives behind this AEUFTA are more comprehensive than in conventional FTAs that deal specifically with trade in goods and services.

A representative from the DGTEC concurred with her Jakarta counterpart.[87] According to her, the EU recognizes that the type of trade agreement it wishes to conduct with ASEAN is probably more comprehensive and substantial than the BFTAs that ASEAN has pursued so far. These BFTAs cover only the trade in goods and services, and often gloss over other issues, such as investment, competition policy, etc. This EU representative felt that there would be economic benefits only if both regional organizations are willing to work beyond tariff issues. At the same time, however, the EU also recognized that the AEUFTA will use up many resources on the ASEAN side. The EU will thus have to provide help with technical and capacity building issues. Although there were initial setbacks on the modalities of the AEUFTA negotiation, the EU finally agreed to utilize the *ASEAN Minus X* or *Ten-X* formula whereby the agreement could firstly be concluded by countries that were ready, leaving other countries to accede at a later time. Under this formula, the ASEAN-7 members[88] should commence AEUFTA negotiations with the EU. The EU hoped that the AEUFTA negotiations would be concluded within two years, effective from July 2007.

Other EU representatives also hold EU–ASEAN relations in high regard. The UK representative on the Article 133 Committee (hereafter referred to as the Article 133 UK representative), for example, argued that ASEAN holds a key position in the wider Asia-Pacific region. Its dedication to peace and stability and its economic weight make it a credible partner for the EU.[89] In the area of trade and economic cooperation, the Cypriot representative on the Article 133 Committee (hereafter referred to as the Article 133 Cypriot representative) also noted that currently ASEAN makes up about 5.8 percent of total EU trade with the world, while the EU takes about 15 percent of ASEAN's exports.[90] The representative of the Green Party in the European Parliament also recognized how important it was for the EU to engage with ASEAN, particularly as ASEAN has recently adopted an integration model based on similar principles to those of the EU. There seems to be some sort of moral obligation on the European side to share its experience of integration with the equally diverse region that is ASEAN. This respondent also pointed out that the AEUFTA was an opportunity for the EU to compete with China, Japan and the U.S., not only in the Southeast Asian region, but also at the global level.

86 Interview with a member of the Trade and Economic Section, EC Delegation to the RI, Brunei Darussalam and Timor Leste, Jakarta, 20 June 2007. The respondent stated that responses would be of a general nature (as opposed to official). This is why the respondent's identity has been withheld.

87 Interview with a representative of the Unit for Trade Relations with South Korea, India and ASEAN, DGTEC, Brussels, 21 June 2007. This respondent wished to remain anonymous.

88 Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam.

89 Completed questionnaire received 30 July 2007 by electronic mail from Duncan Adams, senior policy analyst, UK Department for Business, Enterprise and Regulatory Reform. Adams is the UK representative on the Article 133 Committee.

90 Completed questionnaire received on 17 July 2007 by electronic mail from Eleni Pitsillidou, trade officer, Cypriot Minister of Commerce, Industry and Tourism. Pitsillidou is the Cypriot representative on the Article 133 Committee.

Economic players in the EU also welcomed the AEUFTA because it would strengthen ASEAN–EU economic relations. Representatives from the Association of European Chambers of Commerce and Industry (Eurochambres)[91] and the European Services Forum (ESF)[92] commented on the importance of improving ASEAN–EU economic relations. Citing statistical figures from the European Commission, the representatives from both business associations noted opportunities for firms from both regions arising from the AEUFTA. Eurochambres in particular welcomed the fact that ASEAN is more committed to economic integration initiatives. This business association thus felt that the EU should place ASEAN higher on its agenda. The ESF representative highlighted that existing foreign relations mechanisms, such as ASEM, were inadequate in promoting economic relations between the two regions. It was hoped that the AEUFTA would improve these economic relations.

Other key representatives from pan-European businesses in Brussels declined to be interviewed. However, their official position on bilateral FTAs was gleaned from the organizations' websites. The Union of Industrial and Employers' Federation of Europe (Union des Industries de la Communauté Européenne, or UNICE)[93] and the European Apparel and Textile Organization (Euratex), for example, were generally supportive of the EU's move towards a BFTA strategy, although felt that the conclusion of the DDA should remain the EU's main goal. Information on the UNICE website (2006: 9) suggested that the organization believed that bilateral and regional trade arrangements are essential elements of the EU's strategy to maintain its good position in the global market. UNICE proposed that the EU should adopt robust and ambitious FTAs to achieve economic integration with countries that are economically important for EU exports. Euratex (2006: 1) also welcomed the European Commission's policy on BFTAs. Euratex advised the EU to push not only for reciprocity and symmetry, but for an early conclusion to negotiations and the rapid implementation of agreements so that the European textile and clothing industry can access rapidly growing markets as quickly as possible.

Developmental aspects of the AEUFTA

Bureaucratic and civil society groups in ASEAN and Indonesia

Development is the central issue in this study. There is a global consensus in the world today that development should be the objective of international economic and trade arrangements. Development is still a hotly debated subject, not only among countries, but also within societies. As with many other economic and trade agreements that ASEAN and the EU are engaged in, development should be the AEUFTA's key objective. Representatives from the ASEAN Secretariat, the Royal Embassy of Thailand and the Malaysian Embassy stated that the different levels of development among trading partners should be taken into consideration. They felt that the developmental aspect of an economic arrangement should encompass all aspects of human development, such as physical, mental, technological and infrastructural areas. According to these three respondents, development should play a significant role in the AEUFTA negotiations because of the different level of development not only among, but also within, ASEAN member countries. This would mean that countries and/or sectors that are not yet ready to face full liberalization would be given concessions. There would also be technical assistance programmes to assist the more economically weak countries to pursue their development objectives. The representatives from Deplu and Deptan also felt that because the levels of economic development in

91 Completed questionnaire received on 30 June 2007 by electronic mail from Paul Fournier, trade advisor, Eurochambres.

92 Interview with Pascal Kerneis, managing director, ESF, Brussels, 27 June 2007.

93 As of 23 January 2007 UNICE is known as the Confederation of European Business (or Business Europe).

Southeast Asia differed from country to country, development was an extremely important issue in the AEUFTA negotiations. The Deplu representative also added that ASEAN should learn from the experience of European countries, where regional integration complemented the developmental objectives of EU member countries.

Indonesian civil society groups also saw development as the key issue of the forthcoming AEUFTA negotiations. A former member of the Expert Group on AEUFTA, Dr Djisman Simanjuntak, suggested that developmental issues are tricky for both ASEAN and the EU. The two groupings have been unable to reach a consensus on the definition of development cooperation. The EU sees trade and investment liberalization as an important way of helping Southeast Asian countries to develop. Many ASEAN member countries, however, have been half-hearted in their approach to trade liberalization. It is thus crucial that an alternative approach be found. Some ASEAN members have already been granted special market access to export their products to the EU through the Everything But Arms arrangement. It is expected that this market access will be extended to other developing countries within ASEAN. Other measures, such as capacity building, have also been planned. Some civil society groups see development as a means of gradually improving living conditions in ASEAN. Nearly all of the NGO representatives interviewed reiterated that this matter needs attention in any future AEUFTA negotiations. Indonesian civil society groups would prefer that ASEAN and the EU adopt measures other than BFTAs to achieve their development objectives. As it is likely that BFTA negotiations will proceed, some key development issues were identified, i.e., (1) the need for absolute flexibility in the schedule and sectors to be included in the trade liberalization arrangement; (2) the need for the inclusion of the right of ASEAN governments to adopt trade defence mechanisms, such as the SPM and SSM; (3) the need for technical assistance and capacity building; and (4) the need for greater market access to the EU. Most groups, however, were unsure whether ASEAN and Indonesia would benefit developmentally from the AEUFTA.

Bureaucratic agencies and civil society groups in the EU

How different actually are the views of ASEAN and EU member governments concerning development issues? From the recommendations put forward by the ASEAN–EU Vision Group and the discussions held between the European Commission and ASEAN, it is clear that the AEUFTA would be a trade agreement between the EU and a group of developing countries. The EU was advised to approach the AEUFTA negotiations and implementation flexibly. According to officials at the DGTEC and the EC Delegation to the RI, Brunei Darussalam and Timor Leste, the EU had started to recognize that ASEAN's extensive use of special and differential treatment mechanisms in the form of longer timelines for countries to liberalize was reasonable and sensible. The EU was expecting to provide capacity building and technical assistance during both the negotiations and the implementation phase. For the EU, however, the concept of *sustainable development* is more important than simple development, which is why it continues to carry out *sustainable impact assessments* on many of its trade negotiations in order to highlight any areas where problems may arise. Such assessments usually lead to a series of recommendations for the negotiating parties to consider. The EU, however, is reluctant to accept ASEAN's use of trade mechanisms, which the former sees as having a trade distorting effect, particularly if such mechanisms contravene WTO rules.

EU member countries share the same views as the European Commission representatives. The Article 133 UK representative, for instance, saw how important it was that both the EU and ASEAN are committed to sustainable development. He also stressed how international trade could contribute to such development, including economic development, poverty reduction, full and productive employment, and the preservation of the environment and natural resources. The Article 133 Cypriot representative also added that the developmental aspects of the AEUFTA should support all developing countries, particularly the least developed ones. Both representatives thus saw how important it was to include a developmental slant to the forthcoming AEUFTA negotiations as a way to promote economic development in the Southeast Asian region. The respondent from the Green Party in the European Parliament, however, had a more extreme definition of development, defining it in terms of (1) enabling policy space for an indigenous path to sustainable economic growth; (2) emphasizing the development of domestic markets and domestic financial resources; (3) embedding such policy space in global rules of the fair pricing of exported goods, particularly agricultural products; and (4) protecting infant industries in developing countries from undue global competition.

For many European economic players, however, the concept of development has many meanings, some of which do not necessarily correspond to the development objectives of Indonesian civil society groups. For the Eurochambres representative, for instance, a developmental perspective has two angles: one is economic, while the other relates to the fair distribution of wealth and resources. The aim of the developmental aspects of the AEUFTA negotiation is to improve and increase the living standards and quality of life of ASEAN and European citizens. Unfortunately, economic growth does not always necessarily promote an increase in wealth, and even if it does, the fair distribution of wealth and resources is often difficult to implement. The ESF representative also identified two strands to development. On the one hand, firms normally associate development with the chance to develop business opportunities (e.g., set up operations in a new country or expand existing operations). On the other hand, development at the political and macroeconomic levels refers to potential trade agreements to promote the sustainable economic development of the exporting and importing trading partners. For this interviewee, however, economic openness is key to economic development. The entrance of foreign firms into a local economy can contribute to the economic development of the host country, because such firms create enduring relationships with local employees, consumers, and, more importantly, the services sector and business consumers, most of which are small and medium-sized enterprises. This viewpoint, however, is flawed. A country should implement economic reforms that put in place stringent investment rules prior to opening up its economy, thus minimizing the potential negative impacts that all too often result from foreign investment.

On issues related to trade and investment

On 4 May 2007 the ASEAN economic ministers (AEM) and the EU trade commissioner met in Bandar Seri Begawan, Brunei Darussalam, for the Eighth AEM–EU Consultation.[94] The ministers and the EU trade commissioner confirmed a shared desire to enhance economic relations by establishing an FTA, thereby facilitating comprehensive trade and investment liberalization. On 24 July 2007 the ASEAN Secretariat's Bureau of Economic Integration representative confirmed that ASEAN member countries and the European Commission are now in the midst of preparing the modalities of the FTA negotiations. Because such modalities could include anything that the negotiating teams mutually agree on, the present study undertook to collate the opinions of different state and non-state actors from the EU, ASEAN and Indonesia in nine areas. These areas have either figured prominently in past trade agreements or have been identified in studies as areas anticipated to be of increasing interest in talks concerning the AEUFTA. The nine areas, their respective discussions and a summary of opinions culled from the respondents are laid out below.

94 From <http://www.aseansec.org>, accessed 20 June 2007.

Market access (public sector barriers)

The respondents answered questions on the trade defence instruments (TDIs)[95] employed by EU member states, the TDIs employed by ASEAN member states—Indonesia in particular—and market access. One question concerned the likelihood that the AEUFTA will give ASEAN exports easier access to the EU market. The responses are outlined below.

Bureaucratic and civil society groups in ASEAN and Indonesia

The respondents were asked whether market access plays an important part in the negotiations. In general, the respondents believed this to be the case. The opinions of state actors and members of the academic community can be summed up as follows:

(1) Market access is the major or main objective of trade facilitation and will thus have an important role in the negotiations.

(2) All parties have a general interest in market access.

(3) Market access is inextricably linked to production. Goods, products and services are not created unless there is a market for them. ASEAN markets have always been lucrative for European producers.[96] ASEAN exporters need to make full use of any available markets.

Mohammed Razak, an official from the Malaysian Embassy, advised that where market access appeared on the negotiation agenda would depend largely on what products ASEAN intends to export to the EU. Market access negotiations will thus depend on the industry or product strategy. Most NGOs also saw this issue as important. For them, market access stands to affect the flow of goods from ASEAN to the EU, and vice versa.[97] One NGO stressed that market access was important in ensuring that Indonesian products are given the chance to be exported to the EU directly from Indonesian ports, and not from Malaysian and Singaporean ports.[98] The respondents felt that the issue of certain EU members imposing measures that were unfavourable to imports was very relevant and thus crucial to the AEUFTA negotiations.

Although some state actors acknowledged that maintaining such measures was well within a country's rights under current WTO commitments,[99] many felt that this matter was crucial. One respondent stated that the way in which the EU has maintained such measures contradicts its supposed commitment to free trade ideals.[100] Another state actor stated that such measures are removed or maintained depending on the industry and products involved.[101] The KADIN representative cited the opportunity to market Indonesian products in the EU as the reason why such measures should be discussed.

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95 Quantitative restrictions on textile and clothing, anti-dumping actions, trade defence and safeguard measures, phytosanitary and sanitary measures, and technical requirements.

96 Interview with Dr Hariyadi Wirawan, Faculty of International Relations and Political Science, University of Indonesia, Depok campus, 25 June 2007.

97 As articulated by the Bina Desa representative.

98 Interview was conducted with Nurrudin, coordinator of the Indonesian Farmers' Alliance (Aliansi Petani Indonesia, or API), Jakarta, 13 September 2007.

99 As articulated by the Deplu representative.

100 As articulated by the Deptan representative.

101 As articulated by the Royal Thai Embassy representative.

Respondent Simanjuntak advocated that ASEAN has to be fair concerning this matter,[102] yet also acknowledged that the EU's use of TDIs has created problems. He spoke of two problems: tariff peaks and tariff escalation. According to him, the EU maintains a number of high tariffs in limited positions of common commodity nomenclature. They include textiles, rubber products, furniture, agriculture and food, all of which are relevant to ASEAN. As far as tariff escalation is concerned, this means that the EU imposes zero or very low tariffs on unprocessed products, but very high tariffs on processed products, providing an incentive for the export of unprocessed goods. This has acted as a barrier to the development of some industrial sectors. Low tariff rates for unprocessed products will serve as an incentive for countries that are low level producers of these products. High tariffs on processed or semiprocessed products are a significant challenge to industrializing nations. Confronted with high tariffs for processed products and low tariffs for unprocessed ones, it is easy to imagine a developing country abandoning plans for industrialization and opting instead for agricultural production. Tariff peaks and tariff escalation as a method of breeding farming or fishing nations without any manufacturing bases has been discussed in other works (see, for example, Robles, 2007).

NGOs also felt that the maintenance of TDIs by the EU was an important issue, but provided different reasons for this in line with their different areas of interest. Some believed that maintaining TDIs impedes the building of trade relations grounded on mutual cooperation and fairness,[103] and therefore felt it to be an important issue for the forthcoming negotiations. Others believed that maintaining TDIs is central to trade facilitation,[104] given that such measures can hinder or distort the flow of trade. Two NGO respondents discussed this issue with regard to disparities between the capacities of different governments. One respondent was particularly concerned about a government's ability to grant subsidies to farmers, while the other saw the removal of EU TDIs as some form of reverse affirmative action, which would help restore some semblance of equality between two countries.[105] When asked to identify specific areas of concern relating to EU TDIs, the respondents identified the following areas: high import tax rate;[106] sanitary standards; phytosanitary standards;[107] subsidies for the agricultural sector; non-tariff measures such as health measures; and measures that in general affect agriculture, leather and textiles.[108] With regard to ASEAN TDIs, the respondents agreed that these will be an important issue during negotiations. The replies centred on two points: the disparity in development between the two regions and, by extension, the need to protect domestic industries.

Respondent Razak of the Malaysian Embassy explained that under trade liberalization certain sectors need to be protected, especially those sectors already long developed in Europe. He intimated that the EU has to understand the reasons behind some *protectionist policies* in ASEAN. Governments such as Indonesia and Malaysia impose tariff barriers to balance the impacts of a liberalized tariff regime against development concerns such as nurturing infant industries or a fledgling manufacturing base.

The Deplu representative, Achsanul Habib, pointed out that governments have the right to preserve policy space with respect to certain areas of development. Such measures, he further stated, are '*normal*':

102 He cites the fact that around 70 percent of the goods imported into the EU are free of duty (zero duty).

103 Interview with a representative of Make Trade Fair Indonesia (Serikat Bersama Indonesia Berseru), Jakarta, 28 September 2007.

104 Interview with Surya Tjandra, representative of the Trade Union Fights Centre (TURC), Jakarta, 19 September 2007.

105 As articulated by the API and Kibar Kediri representatives. Electronic mail interview with Dian, Kibar Kediri representative, received 14 September 2007.

106 As articulated by the Bina Desa representative.

107 As articulated by Mohammed Razak of the Malaysian Embassy.

108 As articulated by the Royal Thai Embassy representative.

they are allowed under the WTO regime and are subject only to registration.[109] That the second set of replies repeatedly cited the need to maintain these measures because they shield domestic industries from being overwhelmed by imported products came as no surprise. All the respondents were aware of the disparity in the levels of development between the regions and recognized a government's prerogative to shield domestic industries. The majority of these replies came from the NGOs[110] who work closely with marginalized sectors such as farmers and rural communities. There was a high degree of consensus among the ASEAN respondents concerning the importance of Indonesian TDIs in the forthcoming negotiations.

Bureaucratic and civil society groups in the EU

The EU respondents believe that an AEUFTA will facilitate the market access of ASEAN products to the EU. The EU market is open to manufactured goods and already offers ASEAN good market access.[111] The AEUFTA will provide benefits in the form of further economic cooperation between the two parties,[112] provided that the FTA is comprehensive, deep and encompasses all trade. If these conditions are met, the EU expects *the propensity of the EU to import goods from ASEAN to increase*. The question of whether the maintenance of measures by certain EU members is unfavourable to imports was seen by EU respondents as an important issue in the forthcoming negotiations, depending on the policy in question. The representatives from the DGTEC and the EC Delegation to the RI, Brunei Darussalam and Timor Leste believe that this issue will not be important for two reasons. They pointed out that such matters have already been tackled by the WTO and commitments have been made in this regard. There is an expectation that states will adhere to these commitments and that no further action is necessary. Tariffs for agricultural products, however, have always been up for discussion due to strong lobbying from both ASEAN and the EU, while services and standards, especially health standards, are also expected to be included in negotiations.

The representative from the Green Party also thought the issue would not be particularly important, but for entirely different reasons. He thought that instruments such as TDIs serve some positive purpose, in that they preserve policy space in the EU and can be used to create a more level playing field for different importers from developing countries. The Article 133 UK and Cypriot representatives believed that EU TDIs are of some importance, although the Cypriot representative believed that this importance depends on the particular policy in question. Free competition for all agricultural products, for instance, would be important. The UK representative pointed out that the UK advocates strongly for free and fair trade and, as an EU member, strives for this. He also believed that NTBs should also be put on the negotiating table, as reducing them could greatly improve the possible economic effects of an AEUFTA.

Most respondents felt that ASEAN maintained measures that are unfavourable to imports constituted a serious issue, citing a common belief that any measure that hinders the flow of trade or has trade distorting effects is an important matter. Respondents mentioned the need to tackle tariff and non-tariff barriers and to address measures that provide unfair competitive advantages to Indonesian companies. When asked to cite some areas of concern, the respondents mentioned (1) tariffs on the automobile and chemical industries; (2) measures, technical regulations and administrative restrictions on trade in goods and services that had the effect of NTBs; (3) investment policies; (4) government procurement barriers; and (5) nationality provisions.

109 Some measures are not allowed under the WTO *outright*, like mandatory performance requirements or export/import requirements that are tied in with the receipt of a subsidy.

110 All the NGOs, in fact, cited the need to protect domestic industries from the aggressive flow of imported products. Respondent Wirawan also cited the need to stall the flow of goods from Europe.

111 As articulated by the Article 133 UK and Cypriot representatives.

112 As articulated by the representative from the EC Delegation to the RI, Brunei Darussalam and Timor the U.S. and EU, are in favour of the negative list approach, while most developing countries and regional groupings, such as ASEAN, opt for the positive list approach.

Private sector barriers (PSBs) to trade: A short incursion into competition policy[113]

A corollary issue to market access is that of competition policy in the context of PSBs to trade. For many years, the international community has been trying to remove hindrances to the flow of trade,[114] otherwise known as PSBs. With the slow dismantling of such PSBs presently taking place, attention is now focusing on domestic PSBs. The respondents acknowledged that competition policy should be at least mentioned during negotiations. Respondent Simanjuntak pointed out the relevance of competition policy to the AEUFTA negotiations, citing how competition comes into play when economies are linked through trade and investment. State actors echoed Simanjuntak's views, with the ASEAN representative indicating that competition policy has already been identified as an issue to be considered in the ongoing modalities.

The respondent from the EC Delegation to the RI, Brunei Darussalam and Timor Leste indicated there was a *possibility* that the EU private sector would accept the FTA terms on competition policy, so long as it is guaranteed market access to ASEAN. This may not apply to EU sectors that have traditionally lobbied strongly against imports, such as the agricultural and textiles sectors. Private sector cooperation in the EU may prove to be *easier said than done*. As the Deplu representative noted, national governments in the EU find it more difficult than their ASEAN counterparts to tell their private sectors to address problems such as PSBs to trade. He further noted that negotiations with EU governments might not be the most appropriate way to address PSBs, as direct talks with the business associations concerned have in the past been more effective. This seems to be a tacit acknowledgement that in current politics and diplomacy, government-to-government talks alone do not govern world affairs. Therefore, when dealing with the issue of PSBs, negotiators from the Indonesian and ASEAN sides should consider whether the EU private sector has made any final commitment, firstly, to cooperate with the EU trade authorities and, secondly, to implement any FTA provisions to remove PSBs. Anything less would not lead to any real benefits for ASEAN and Indonesian enterprises.

Agricultural subsidies

ASEAN is a disparate regional grouping. Brunei and Singapore import most of their food; approximately 40 percent of the population of the Philippines and Indonesia engage in agricultural production; while around 75 percent of the Lao PDR population are engaged in agricultural production.[115] The EU also has a rural population, and its food and agricultural sector is composed largely of small food producing farms that coexist alongside large companies that supply input, food processing and retail services. Agricultural subsidies are thus of special significance to both sides.

Bureaucratic and civil society groups in ASEAN and Indonesia[116]

All the respondents stressed that large sections of the populations of most ASEAN countries are engaged in agricultural production. This factor, one respondent pointed out, is at the heart of the forthcoming negotiations. The representatives of the ASEAN state actors stated that agricultural subsidies were important, but perhaps more so to the EU than to ASEAN. They anticipated that countries such as Poland and Romania would be concerned about this issue because they have large rural or agricultural

113 This question was not presented to the Indonesian NGO respondents.

114 See, for example, Fedderson (1998: 75–79).

115 See, for example, European Commission (2006d).

116 Respondents were asked the following question: How would you or your organization rate the issue of agricultural subsidies in the future AEUFTA negotiations? Respondents were asked to rank their answers from 1 (least important) to 5 (very important). They were also asked to provide brief explanations for their answers.

populations. It was also thought that agricultural subsidies would probably be of more importance to the EU because EU members provide large subsidies to their agricultural sectors.[117] Compared to the EU, ASEAN provides very few subsidies. In the words of one respondent, ASEAN governments grant such subsidies to assist subsistence and small farmers; they do not seek to create unfair advantages vis-à-vis international competitors.

Respondent Simanjuntak added that agricultural subsidies might have less impact on ASEAN, since most ASEAN exports to the EU do not fall into the category of agricultural products. He pointed out that most ASEAN exports to the EU are manufactured products originating from private and agricultural sources. On the other hand, most grassroots level respondents still view agricultural subsidies as a very important issue—some even called agricultural subsidies an obstacle to the flow of trade and a stumbling block for WTO negotiators. Four NGOs saw agricultural subsidies as a core concern of their organizations because to the majority of Indonesians agriculture is still an important source of income. Farming was identified as fundamental and crucial to self-reliance, and agricultural subsidies were thus seen as *a determining issue for most people in Indonesia*.

Bureaucratic and civil society groups in the EU[118]

State actors also felt that the issue of agricultural subsidies was important, but wanted to see the matter dealt with on the multilateral, rather than the regional or bilateral, level. The EU's agricultural subsidies will be an important issue in the forthcoming FTA negotiations because they benefit rural populations and protect the environment. One respondent noted that ASEAN has moved away from purely agricultural production and into manufacturing more sophisticated products—thereby implying that agricultural subsidies may not be relevant to ASEAN and the FTA. The Green Party representative felt that agricultural subsidies of the export supporting kind are generally wrong and ought to be abolished. The same respondent did, however, agree with the Cypriot and UK Article 133 representatives that subsidies that support rural populations are justifiable.

Tariff liberalization[119]

Bureaucratic and civil society groups in ASEAN and Indonesia

In general, the Indonesian respondents rated tariff liberalization as an important issue in the AEUFTA negotiations. Bureaucratic and academic stakeholders tended to agree, whereas the NGOs provided mixed replies: some rated tariff liberalization as unimportant or slightly important, while others rated it as important, if not very important. The representatives from the Malaysian and Thai Embassies thought tariff liberalization was a *very important* issue when seen in the context of each nation's programme of liberalization. Areas of concern included tariff peaks and escalations. Respondent Wirawan of the University of Indonesia believed that tariff liberalization is still needed as some goods are essential for certain region's economies. Respondent Simanjuntak of the Jakarta-based CSIS seemed to agree with this, adding that this should be a relatively easy area for negotiators to make progress in.

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117 This statement is backed up by the IMF's 2002 World Economic Outlook analysis, which states that EU support for agriculture made up 35 percent of farmers' income. For further details of this analysis, see IMF (2002).

118 The question was as follows: In your organization's opinion, how important an issue is the maintenance of agricultural subsidies to the EU? Respondents were asked to rank their answers from 1 (least important) to 5 (very important). They were also asked to provide brief explanations for their answers.

119 Respondents were asked to rate the importance of tariff liberalization in the upcoming negotiations on the AEUFTA through answering the following question: How will tariff liberalization figure in future AEUFTA negotiations? They were also asked to identify the areas covered by tariff liberalization that were of particular interest to them.

Among the NGOs, Make Trade Fair Indonesia, Bina Desa and the API rated this issue as either *important* or *very important*. Kibar Kediri, the Trade Union Rights Centre (TURC) and the INFID, on the other hand, rated the issue as either *not important at all* or *slightly important*. Some identified specific concerns with regard to the issue, particularly the use of tariffs as a means to promote infant industries or as a means to facilitate market access to the EU. Kibar Kediri also expressed concern over the rapid pace of Indonesian liberalization, as such rapid liberalization has harmed the economy.

Bureaucratic and civil society groups in the EU

Due to the long standing commitment of both the EU and ASEAN to tariff reduction, the EU respondents thought that there was little to discuss about this matter during the forthcoming FTA negotiations. The EC Delegation to the RI, Brunei Darussalam and Timor Leste representative acknowledged that tariff levels are already low. From a more general point of view, the Article 133 UK representative replied that as far as tariff liberalization is concerned, the UK does not take a mercantilist approach, but wishes instead to see full and early liberalization of tariffs in an FTA that substantially covers all trade. Some respondents regarded certain areas as either *important* or *very important*. These areas included the car, chemicals[120] and pharmaceuticals industries, as well as the export of certain agricultural products, like citrus fruits.[121] The Article 133 Cypriot representative pointed out that Vietnam imposes 40 percent import duty on citrus fruits and a 5–15 percent tariff on pharmaceuticals.

The Green Party representative stated that the general model followed for FTAs is not concerned with tariff liberalization on a gradual basis, buts seeks rather to reduce compulsory tariffs to zero. It was felt that this *drive to zero* was at odds with the challenge of maintaining incentives for trade in green technology and for the social and environmental aspects of trade. The Green Party representative felt that governments would find it hard to integrate environmental policies into trade policies.

Service sector liberalization

Service sector liberalization has become an issue in recent years now that trade and direct investment in services features significantly in the world economy.[122] The principal service providers are located in major capital exporting countries (such as the U.S. and EU), who, in pursuit of markets, seek the opening of host countries whether through cross border trade or, where necessary, through establishing operations in host countries.[123] Conflict with countries where the service sector is less developed arises due to the high degree of service sector regulation in these countries. The AEUFTA, being an agreement between a region of mostly capital exporting countries and a region of capital importing countries, will most likely include provisions on services. Respondents were asked how they thought the issue of services would figure in the negotiations and how important it was for the EU to pursue a negative list approach in this regard.[124]

120 As articulated by the EC Delegation to the RI, Brunei Darussalam and Timor Leste.

121 As articulated by the Article 133 Cypriot representative.

122 See, for example, the UN Code on Transnational Corporations (UN, 1990).

123 See Muchlinski (1999: 251).

124 A negative list approach means that sectors listed by the governments involved in a BFTA are not subject to liberalization. The positive list approach means that governments list the sectors that will undergo liberalization in the agreement. The negative list approach is a more aggressive form of liberalization than the positive list approach. Major developed countries and regional groupings, such as the U.S. and EU, are in favour of the negative list approach, while most developing countries and regional groupings, such as ASEAN, opt for the positive list approach.

Bureaucratic and civil society groups in ASEAN and Indonesia

The RI-based respondents, in general, saw service sector liberalization as an important issue for the upcoming AEUFTA negotiations that was of more importance to the EU than to ASEAN. Although there was some divergence among the answers, certain trends did emerge. Firstly, there was tacit acknowledgement among RI-based respondents of the disparity or imbalance between the two regional groupings. The EU, observed the Thai Embassy representative and respondent Simanjuntak of Indonesia, has a more developed service sector, but ASEAN countries have put little effort into driving their own service sectors forward. Respondent Wirawan pointed out that ASEAN countries are still largely agricultural and the service sector plays only a small part in the economies of most ASEAN countries. Simanjuntak, a seasoned negotiator and long standing expert on trade related matters in the region, also acknowledged that 'services is a kind of jungle for us. We don't know our service sector … so we need to learn fast'.

Secondly, it was acknowledged that the issue would be a difficult one, owing to the fact that services have been much protected by both sides.[125] Services, remarked the Thai Embassy representative, include issues such as worker mobility, immigration and the opening of particular sectors to foreigners. This respondent felt that it would be difficult to reach any conclusion or agreement on this matter. Simanjuntak remarked on how certain service sector areas—such as telecommunications, banking, financial services and stock broking, and airline services—remain highly regulated and protected by both the EU and ASEAN, despite the EU's emphasis on service sector liberalization. These difficulties notwithstanding, he suggested that perhaps ASEAN should see service sector liberalization as tied being in with investment.[126] He remarked that in order to be internationally competitive, ASEAN services needed investment and new technologies. Airline companies, hospitals and educational institutions, he said, cannot be competitive unless they have new aircraft, equipment and/or technologies. Although ASEAN members may expect few benefits from the negotiations over services, Simanjuntak advised that reciprocity would be crucial to the negotiations. Well developed sectors in ASEAN, such as tourism, may push for further benefits, while other sectors are put forward for liberalization.

Thirdly, it was thought unlikely that Indonesia would benefit from service sector liberalization. The respondents from business and civil society groups were unanimous in their belief that Indonesia stands to lose a great deal from this, largely due to the imbalance between the regions, which some respondents, such as the Bina Desa representative, believed the EU is only too happy to exploit. Bina Desa was of the opinion that if allowed to do so, the EU would take over the Indonesian services sector, despite the various liberalization measures already undertaken through multilateral, regional and bilateral agreements. KADIN believed that Indonesia's human resources are not up to the challenge of service sector liberalization at the moment and Indonesia could end up losing the sector to foreign service providers. KRuHA pointed out that Indonesia has already opened its water sector to foreign companies. The entrance of two multinationals (Lyonnaise and Thames) has disadvantaged Indonesian citizens through increases in water tariffs and poor services. Finally, respondents found it difficult to say how the EU's pursuit of a negative list in the negotiations would impact on the service sector. This is because the current modality used for service sector liberalization negotiations under the GATT follows the positive rather than negative list approach. The difference in approaches will, to quote the Thai Embassy representative, make this a difficult matter to deal with.

125 As articulated by respondent Simanjuntak.

126 *Commercial presence* falls under Mode 3 of the GATS.

Bureaucratic and civil society groups in the EU

There was unanimous agreement among EU based respondents that services sector liberalization would be an important issue during the negotiations. The representative from the DGTEC acknowledged that ASEAN will find it difficult to negotiate over services, since it has yet to liberalize this sector, as the EU knows. However, the representative believed that if ASEAN wants to succeed in its aim to create an AEC, it should follow in the EU's footsteps. It is not only goods that should be liberalized, but also services. Financial services; the environment; construction; distribution; wholesaling;[127] accounting; auditing; and the architectural, legal and advertising sectors were all identified as being of interest to respondents.[128] The Green Party representative believed that certain service sectors, such as public services, services of general interest and cultural services should not be liberalized, as these constitute policy instruments. Their value thus supersedes any potential economic gains derived from liberalization.

Pascal Kerneis of the ESF replied on this point at some length. The ESF has obvious interests in service sector liberalization and thus feels that it will be an important issue in the upcoming AEUFTA negotiations. However, in a letter to EU Trade Commissioner Peter Mandelson,[129] the ESF indicated some basic expectations in relation to the negotiations. Among these expectations are the following:

(1) The conditions for a comprehensive package on service sector liberalization must be made clear by the EU to all potential negotiating partners before talks are opened.

(2) The motivation for any new agreements should be based on economic criteria as outlined by the European Commission.[130]

(3) A negative list approach should be used in FTA negotiations.

(4) There should be fair, proportionate and transparent regulatory frameworks, whereby potential EU partners must display a commitment to transparency, meet the test of necessity and proportionality with respect to quality regulations, agree to employ sectoral disciplines so as to ensure that commitments on market access and national treatment are made workable, and ensure effective regulatory cooperation; and, where applicable, there should be mutual recognition agreements.

(5) Trade facilitation should be a part of negotiations.

With regard to Indonesia, the ESF is concerned about the foreign equity cap on FDI. This relates to a country's ability to exercise effective management over a subsidiary established in that country, which, in turn, may determine whether an enterprise will invest in a country or will influence the mode of investment undertaken by a potential investor. As Kerneis explained, 'if you do not have at least 51 percent, or at least 50 percent plus 1, of the votes, meaning if we do not have majority control of the company, we are not going to invest in the same way'. The ESF also wished to see a good regulatory

127 As articulated by the representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste.

128 As articulated by the Article 133 Cypriot representative.

129 See ESF (2007).

130 These factors include: (1) the size and growth perspective of the targeted markets; (2) existing levels of protection for the domestic players (e.g., services regulations, public procurement rules, tariffs, etc.); (3) the state of play of the current conditions and possible other bilateral negotiations going on with other trading partners; and (4) a common level of ambition and expectations on both sides before embarking on negotiations.

system in Indonesia that would ensure that the market is secure, stable and open. In short, investment will depend on the presence of legal securities made through a binding commitment. The ESF does not want to see these terms change when governments change as a result of, for example, a coup d'état. Kerneis pointed to the recent example of Thailand, where foreign companies left after the military coup in 2006.

With regard to the negative list approach, the EU respondents felt that it was, in the words of the Green Party representative, the most comprehensive form of investment freedom the EU could hope for in an FTA. However, the respondents were realistic in accepting that this may not be the final outcome. The ESF representative acknowledged that this issue has blocked negotiations between Thailand and Malaysia and the U.S., and it would be unrealistic to hope that ASEAN would agree to the negative list approach. The DGTEC respondent, on the other hand, indicated that if ASEAN opted for a positive list approach for services, then it would have no problem dealing with the matter.

Intellectual property rights

Respondents were asked to rate the significance of IPR in the forthcoming FTA negotiations. They were also asked to identify specific IPR issues that were of special relevance to their respective organizations and to provide brief reasons why this was so.

On how importantly IPR will figure as an issue in the upcoming FTA

All but one of the EU respondents[131] rated this issue as either *important* or *very important*. IPR are linked to investment because a country cannot attract the sort of investment it seeks unless investors are assured of some form of investment protection. The EU respondents pointed out that the IP protection measures sought by the EU are less stringent than those sought by other countries, such as the U.S., and that the EU would not go beyond the relevant WTO commitments. Most Indonesia based respondents[132] said that the issue of IPR was *unimportant* or *slightly important* from an ASEAN or Indonesian perspective. However, the issue of IPR from a protectionist point of view (i.e., when they serve to protect the rights of farmers in Indonesia) was seen as *important* or *very important*.

Specific IPR issues/areas of concern

There was universal acknowledgment from all respondents from ASEAN, the EU and Indonesia that the issue of Indonesia's lack of enforcement of IP obligations under IPR and TRIPS was an important issue. Respondent Sardjono of the University of Indonesia commented that most ordinary Indonesian citizens do not deliberately violate or resist IPR, but, rather, are not fully aware of what IPR represent.[133] There is a huge gap between the legal and popular definitions. Most people, according to the Green Party representative, understand IPR to be a method of promoting a *renter* attitude that serves the interests of rich multinational companies and developed countries in general. IPR make products far more expensive and stifle the free flow of information, and information and new technology become inaccessible unless a steep premium is paid. It is for these reasons that many people resort to piracy, so that poorer consumers can access imitations or copies of these products. Sardjono pointed out that the lack of enforcement may also be a result of inadequate administrative capabilities. A clear example of

131 The Article 133 Cypriot representative rated it a '3' or '*moderately important*.'

132 The representative from the ASEAN Secretariat did not answer questions pertaining to all nine areas, explaining that these matters would be dealt with by the various working groups.

133 As articulated by respondent Sardjono.

this, he says, would be the number of times staff at the Directorate General for Intellectual Property (DGIP) have approved the registration of well known international labels[134] by domestic entities. This suggests, in Sardjono's opinion, that some DGIP officials are ill informed.

Indonesian state and non-state actors were particularly concerned about *the protection of Indonesian agricultural products against corporations and other entities engaging in biopiracy*. Three NGOs, namely Make Trade Fair Indonesia, TURC and Kibar Kedir, emphasized this point. Bina Desa described how Indonesian farmers who have been using and producing agricultural products for generations are now categorized as thieves and IP violators as a result of the menace of biopiracy . Make Trade Fair Indonesia also cited how certain drugs had become inaccessible because of the higher prices caused by the monopolies engendered by IPR. The EU respondents emphasized patents for pharmaceutical products,[135] IPR arising from computer related services, IPR arising from music and audiovisual services,[136] industrial design, and copyright and trademark.[137]

Standards[138]

Bureaucratic and civil society groups in ASEAN and Indonesia

Indonesia based state and non-state actors saw standards as a more important issue to the EU than to ASEAN. The Malaysian Embassy representative thought that the issue was important, but qualified his answer with the point that he expected that the EU would press for a standards provision or section to be included in the FTA. He felt that standards would definitely be an important issue for the EU, as it has traditionally implemented high standards for food products that it expects exporters to comply with, with some products having higher standards than those required by the Sanitary and Phytosanitary Agreement under the WTO Agreement. It was generally acknowledged that standards were a thorny issue. Within ASEAN, it was felt that national standards enforcement is an issue to be dealt with by member countries. Compliance with national standards is a means to improve the quality of locally produced items. ASEAN members are members of a number of standards organizations—so another dimension of the problem is the asymmetry between the national standards that are applied and the international standards required by external bodies such as the EU.

Bureaucratic and civil society groups in the EU

Most EU respondents rated standards as *important*, while a few rated them as *very important*. The representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste indicated that the EU prefers it if international standards are followed, and that sanitary and phytosanitary standards should be prioritized and harmonized in the FTA process. The EU would prefer the agreement to lean more towards a WTO-plus arrangement. When asked to identify which standards were of particular interest to it, the Green Party representative chose the International Labour Organization labour standards and environmental standards, stating that such standards were a means of controlling global trade. The ESF chose standards that apply to both goods and services. As far as services are concerned, standardization means the mutual recognition of licences, educational degrees, professional licensing

134 E.g., Louis Vuitton, Gucci, Ferrari, etc.

135 As articulated by the representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste.

136 As articulated by the ESF representative.

137 As articulated by the Article 133 Cypriot representative.

138 Examples of which include technical standards, phytosanitary and sanitary measures, food safety and food preparation standards, labour standards, environmental standards, etc.

examinations, etc. The ESF would like to see ASEAN adopt international standards for the banking, accounting and insurance sectors.

Government procurement

Government procurement is an important aspect of international trade, given the considerable size of the procurement market (often 10–15 percent of GDP) and the benefits for domestic and foreign stakeholders in terms of increased competition.[139] The efficiency of the procurement process is a primary consideration of every procurement regime. Open, transparent and non-discriminatory procurement is generally considered to be the best tool to achieve *value for money*, as it optimizes competition among suppliers. It also serves goals other than economic value, stated the Green Party representative, such as labour and social policies, integration policies, industrial policies and countercyclical policies of financial stability.

The seemingly universal importance of government procurement was somewhat belied by the marked disparity among respondents regarding this issue. All the EU respondents indicated that they were aware of the underlying issues relating to government procurement[140] and they felt that this issue would figure prominently in the AEUFTA negotiations. The ESF representative explained that the EU has been pushing for liberalization in what is called *public procurement*, a concept that encompasses both government procurement and public services. This encompasses sectors such as construction, architectural services, engineering services, computer and computer related services, and environmental services. The ESF and Article 133 UK representatives mentioned the Government Procurement Agreement (GPA),[141] of which Singapore is the only ASEAN member signatory. The Article 133 UK representative even went so far as to say that the UK would welcome any other ASEAN country that joined the GPA. The representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste stated that transparency is the problem behind government procurement to the extent that 'there is access to public procurement markets; public markets are open, [and] bids are published and equipped with appeal procedures'. If such actions are taken outside the auspices of the WTO and GPA, government procurement becomes an issue of having rules and regulations that increase transparency.

The ASEAN respondents, on the other hand, rated the issue as only *slightly important*. Some respondents even claimed that they did not have any opinions about issues related to government procurement. Some said it was bound up with transparency and governance, and should be dealt with at both an institutional and enforcement level. Respondent Simanjuntak stated that ASEAN would like to put government procurement outside the AEUFTA negotiations.

Foreign investment

Respondents answered the following questions (or slight modifications thereof):

(1) According to you, how important an issue is foreign investment in ASEAN and Indonesia to the EU?

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139 See, for example, WTO (n.d.a).

140 All 27 EU members are signatories to the GPA.

141 This is a plurilateral agreement administered under the auspices of the WTO. To date, only 29 WTO members have signed the GPA. The GPA does not automatically apply to all government procurement of the parties; rather, coverage is determined with regard to each party in the same way that sectors to be committed are identified in the GATS schedule. For further details on parties and observers of the GPA, see WTO (n.d.a).

(2) In your organization's opinion, how important is it for the EU to push for a negative list approach when negotiating foreign investment matters with ASEAN member countries?

(3) Will the FTA improve the investment climate in the EU for ASEAN/Indonesian investors in Europe?

Bureaucratic and civil society groups in ASEAN and Indonesia

Among the state actors surveyed, there was uniform agreement on the importance of foreign investment in the economies of ASEAN member states. Attracting foreign investment for development objectives is a tool that developing countries (such as ASEAN member states) can use to wean themselves off special treatment and preferences. Foreign investment is the *prime mover of the development process*. One respondent emphasized that at this point what Indonesia needs are job generating foreign direct investments and not portfolio investments or those in low job absorbing industries. Another respondent believed that the FTA could improve the ASEAN investment climate, just like the ASEAN Investment Agreement. However, negotiating the liberalization of foreign investment for the trade in services may prove to be more difficult than negotiating the issue of the trade in goods. This is because Indonesia has already liberalized in the area of the trade in goods, where foreign investment is easier to deal with. It is therefore in relation to the trade in services that foreign investment will be an important issue in the upcoming FTA negotiations.

Civil society groups gave a variety of reasons to explain why foreign investment will be an important issue for the AEUFTA:

(1) Some think that investment is one of the reasons why foreign countries pursue trade liberalization policies with other, less developed countries. Foreign investors pursue investment liberalization in poorer, less developed countries like Indonesia because of the large market base and also because of their potential as prospective locations for businesses due to lower or even lax enforcement of labour and product quality standards.

(2) Some indicated that the EU sees immense opportunities in liberalizing trade in ASEAN/Indonesia, especially after the introduction of the new investment law in Indonesia.

(3) Two NGOs expressed concern over government inability to prevent foreign investment liberalization from going too far. They highlighted the importance of making investment not only freer, but more equal and fairer.

(4) One NGO highlighted the issue of prioritizing domestic investment as a means of counterbalancing the presence of foreign investors in the economy.

KADIN rated foreign investment as *slightly important*, and was sceptical about whether policies would actually attract new investors. It is certainly true that the last round of liberalization measures failed to attract any foreign investors to Indonesia. KRuHA pointed out that 'there is no guarantee investors will invest money, no guarantee that investment will be boosted by further liberalization. If we open the market, but no investors come, what should we do then?'

As for the question of whether the FTA will improve the investment climate in the EU for ASEAN investors, respondents were cautious in their answers. They stated that it was difficult to provide a definite rating because this issue involves many factors.[142] The main points are summarized as follows:

(1) Although an FTA could *potentially* improve the investment climate, good infrastructure and law enforcement will also influence whether an investor decides to invest in a particular location. There can be nothing in an FTA to persuade an investor to invest if the prospective location has bad laws and poor infrastructure, and lacks political stability.[143]

(2) The FTA is not likely to improve the European investment climate for ASEAN/Indonesian investors. The opposite is more likely to happen—European investments in Indonesia will grow once foreign investment is further liberalized.

Bureaucratic and civil society groups in the EU

The Article 133 UK representative stated that foreign investment remains an important issue, as it is a crucial means to access markets for many producers. It can also provide an important boost to development if it facilitates the transfer of technology or knowledge. This issue thus generates much interest among European businesses.[144] The EU often sees foreign investment as part of services liberalization,[145] which the EU has pursued more aggressively of late. The Article 133 Cypriot representative pointed out that a negative list is used to promote simplicity and transparency. The Green Party representative thought that a negative list would make it easier for European businesses and bureaucrats to promote liberalization, as it is 'the most comprehensive form of investment freedom the EU can hope for'.

The ESF explained the close ties between foreign investment and services sector liberalization. Most ASEAN countries, including Indonesia, did not include many sectors under Mode 3 ('Commercial Business Presence') of the GATS. This means that many business sectors in ASEAN remain closed to foreign companies, which prevents foreign enterprises from investing in ASEAN countries in order to establish a business presence in the region. Foreign investment liberalization takes away this bar, thus enabling European businesses to invest in the region. For the ESF, this kind of foreign investment liberalization is a key issue and its representative anticipates that it will be high on the list of issues to be discussed and/or negotiated in the AEUFTA.

Other trade related matters

Bureaucratic and civil society groups in ASEAN and Indonesia

One trade related matter of particular interest to ASEAN in general and Indonesia in particular is the GSP. The GSP scheme was initiated in 1971 at the suggestion of the UN Conference on Trade and Development (UNCTAD).[146] The rationale underpinning the scheme is the belief that development goals, such as enhancing export earnings, industrialization and the diversification of economies, can be facilitated by tariff preferences. Tariff preferences, according to this rationale, provide an incentive to traders to import products from developing countries and help them compete in international markets.

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142 As articulated by the representatives of the Royal Thai Embassy, Deplu and Make Trade Fair Indonesia.

143 As articulated by the representative of Make Trade Fair Indonesia.

144 As articulated by the Article 133 Cypriot representative.

145 As articulated by the representative from the EC Delegation to the RI, Brunei Darussalam and Timor Leste.

146 Raul Prebisch, the first secretary general of UNCTAD, first presented the idea of granting developing countries preferential tariff rates in the markets of industrialized countries at the first UNCTAD conference in 1964. The GSP was adopted at UNCTAD II in New Delhi in 1968. For further details on the GSP, see, *inter alia*, UNCTAD (n.d.).

All the Indonesia based CSOs were positive about the GSP and agreed that, as a trade related matter, the GSP is important to ASEAN member countries, particularly Indonesia. Some of the reasons given were: (1) the GSP has proven effective in improving labour conditions in the country; (2) it has boosted export volume; and (3) by allowing ASEAN and Indonesian products to penetrate the EU market, the GSP has served as a means to counter the *selfish nature* of developed countries. Nonetheless, the respondents felt that the GSP could do with some fine tuning. To start with, Indonesia should take steps to ensure that the GSP is used optimally. Secondly, Southeast Asian countries, such as Malaysia and Singapore, should be prohibited from circumventing the rules by importing produce from Indonesia and then selling it on to the EU. Thirdly, the implementation of the GSP should go hand in hand with a strengthening of the rules of origin policy so that such scenarios do not arise.

Bureaucratic and civil society groups in the EU

The EU respondents were asked to identify other trade related areas that they hoped would be included in the AEUFTA. The EC Delegation to the RI, Brunei Darussalam and Timor Leste respondent identified the following areas: rules on anti-dumping, subsidies and countervailing measures with a view to making them all WTO-plus; investment; national treatment; and most favoured nation policies both at the pre- and post-establishment levels. This respondent also indicated that the FTA should identify a mechanism for dispute settlement. The ESF respondent identified trade facilitation as an area to be tackled by the FTA, citing the importance of trade facilitation to many service sectors, such as maritime transport and express delivery services, insurance and reinsurance, financial services, distribution services, etc. The respondent highlighted the example of maritime and express delivery services, which encounter barriers to trade facilitation on a daily basis. If not addressed, these trade barriers impede the rapid movement of goods.

The Green Party representative, on the other hand, identified investment and competition rules as areas to be included in the FTA, but cautioned that 'ASEAN is only interesting to the EU if it enables EU-based transnational corporations to extend their global sourcing and location strategies in the region'. He further warned that policies that allow transnational companies to extend such strategies (e.g., rules on investor freedom, establishment and non-discrimination) are highly detrimental to preserving any kind of national policy space for development in ASEAN countries.

On policymaking related to the AEUFTA

The opinions outlined in the previous sections invite the following questions: *How does one approach negotiations? How long will negotiations run for? What concessions should be considered, given the varying development levels of ASEAN members, and even among the EU members themselves?* Other, more pragmatic questions also arise, such as whether ASEAN can promote regional interests, whether the Indonesian government can promote national economic interests and how far civil society will be allowed to participate in the negotiations. The following section outlines the respondents' answers to such questions.

Why is ASEAN pursuing an FTA with the EU? Why do it now?

ASEAN members do not lack their own trade agreements, which span the full spectrum of bilateral, plurilateral, regional and multilateral agreements. Why then is ASEAN pursuing this FTA with the EU now? The stalled WTO talks seemed to have prompted countries and/or regional groupings to resolve trade issues via other forums. ASEAN sees the FTA as a timely opportunity to move forward, and feasibility studies have shown that there will be benefits. Following the recommendations of the

ASEAN–EU Vision Group, the AEM and the EU trade commissioner agreed to take the ASEAN–EU economic partnership to a higher level, based on two pillars: (1) the establishment of a WTO consistent FTA; and (2) the expansion of economic cooperation to ensure that the benefits from the FTA are maximized and equitably spread among the parties. ASEAN member countries and the EU Commission are now preparing the modalities of the FTA negotiations.

In support of the first pillar, Rony Soerakoesoemah of the ASEAN Secretariat stated that the FTA will be WTO consistent. The DGTEC representative added that the EU does not see any need to go beyond what has already been agreed through the WTO. It would appear that the EU will recommend adhering to any multilateral commitments. ASEAN member countries need to continue to improve their trade relations with their dialogue partners, namely China, Japan, South Korea, the EU, the U.S., Australia and New Zealand, and establishing FTAs can help achieve this goal. ASEAN is thus in the process of establishing FTAs with China, Japan, South Korea, the EU, Australia and New Zealand. The Trade in Goods and Services Agreement under the Framework Agreement on Comprehensive Economic Cooperation has been signed between ASEAN and China, and the Trade in Goods Agreement with South Korea.

In light of these developments, the EU is looking to sign an FTA because it believes that ASEAN is strategically located. Forming closer ties with ASEAN has political, economic and social implications. Economically speaking, the EU recognizes the importance of the ASEAN market to the EU, and vice versa. ASEAN member countries see bilateral and regional FTAs with the EU as part of their strong commitment to trade liberalization. This agreement will also enhance trade relations between ASEAN and the EU. The EU also wants to catch up with other countries in terms of developing comprehensive trade relations with ASEAN, since major world players such as the U.S., China, Japan, South Korea and Australia all have comprehensive economic relations with ASEAN. For years, the main thrust of EU policy with regard to ASEAN has been in the sphere of human rights, and political and security matters, and the EU has neglected economic cooperation up until now. The FTA is born of the need to expand trade and economic relations, and being left behind could have negative consequences. Respondent Simanjuntak of the CSIS explained that those nations or regions that choose to stay outside regional trade agreements are often penalized by such arrangements in that they run the risk of having their products discriminated against. In a world of proliferating FTAs, it is better to jump on the bandwagon than be left out.

Can ASEAN defend its regional interests?

ASEAN and the RI based respondents were asked whether they were confident that ASEAN would be able to defend its regional interests in the negotiations. There was a sharp contrast between the replies received from state and non-state actors. The ASEAN Secretariat representative indicated that he was *very confident* of ASEAN's ability to defend regional interests. There is much at stake if ASEAN does not maintain its central role in the region, which is why it will ensure that its members' interests remain a priority at every regional and international forum. Respondent Simanjuntak, a former member of the ASEAN Group of Experts on the future of the AEUFTA, expressed confidence in the association.

Other state actors felt only moderately confident that ASEAN could defend its regional interests, because ASEAN members have yet to arrive at a consensus on issues over which members have traditionally had conflicts of interest. One NGO highlighted the disparate levels of development among ASEAN members, which might be at the heart of the diverging opinions of ASEAN members regarding certain areas of trade and investment. The majority of the respondents felt only *slight confidence* or *no* *confidence at all* in ASEAN's ability to defend regional economic interests. Most of the respondents pointed to ASEAN's inability to nurture a sense of community in the region. Others also cited the different levels of economic development among member countries as the main stumbling block in achieving a unified position on issues. Ultimately, they believed, varying levels of economic development mean that members will protect their own national interests and try to pursue their own agendas.

The EU respondents were not queried on this issue. However, studies have shown that within the EU trade policy circle, there are doubts about ASEAN's ability to negotiate FTAs and the content of the agreements already signed. Vandoren (2005) claims that many framework agreements signed by ASEAN are 'fairly empty'. Even assuming that an agreement is concluded with the EU, there is no guarantee it will be fully implemented, given that ASEAN has neither a common market nor common trade policy.

Can Indonesia defend its national economic interests?

The Indonesian based respondents (apart from the Deplu respondent) felt either *slightly confident* or *not confident at all* about Indonesia's ability to defend its national economic interests, giving six reasons for this lack of confidence. Firstly, they pointed out that the government has repeatedly displayed weak negotiation skills. Secondly, there were doubts about whether trade diplomats really understood the FTA. Thirdly, there were doubts about whether the government has actually consulted with civil society and the business sector. As the KRuHA respondent stated, 'the government does not listen to us. The government does not respond to what we tell it'. Fourthly, there is no evidence to suggest that the Indonesian government has managed to protect national interests much in the past.[147] Fifthly, it was felt that government policy leant far too much towards liberalization[148] and that most of its economic consultants—many of whom are not even Indonesian nationals—hold liberal ideals. Finally, it was pointed out that government agencies lacked coordination.[149]

What roles do NGOs play?

Ever since the OECD failed to pass the Multilateral Agreement on Investments, governments and state actors have grown to accept the role of civil society and NGOs in policymaking. The ability of NGOs to mobilize groups and pressure governments has been shown repeatedly during the protests against the WTO meetings in Seattle and Cancún, at successive World Bank meetings, and whenever institutions regarded as neoliberal meet in Western capitals (Sornarajah, 2004: 74–75). All the respondents stated that NGO participation was *important*, if not *very important*.

Bureaucratic and civil society groups in ASEAN and Indonesia

The Indonesian and ASEAN respondents felt that NGO participation would be greatest in the policymaking and implementation stages of the FTA for the following reasons:

(1) All stakeholders must be encouraged to become involved to ensure success in implementation.

(2) NGOs have already contributed very positively to the policymaking stage of past negotiations.

147 As articulated by the INFID representative.

148 As articulated by the Make Trade Fair Indonesia representative.

149 As articulated by respondent Wirawan.

(3) To be successful, any agreement needs popular support. Greater support means a greater likelihood of successful implementation of the agreement.

(4) Dialogue between government and different sectors of society must be encouraged,[150] as there is interdependence between the two in the spheres of economic development, social progress and environmental protection.[151] NGOs act as the voice of the people who cannot lobby for themselves.

(5) NGOs pave the way to informed participation in government.

(6) NGOs can make concrete contributions in the dialogue process between government and society,[152] in negotiations,[153] in information dissemination,[154] and in implementation and monitoring.[155]

(7) An NGO presence in negotiations will help to ensure that social welfare and sustainability issues are tackled during negotiations.

According to the Deplu representative, the Indonesian government actively seeks NGO participation because it recognizes the need for a constructive partnership with civil society. The Deplu representative also stated that the government is selective of which NGOs it seeks assistance from for two reasons: (1) not all NGOs have the necessary skills or knowledge in the appropriate field; and (2) an NGO may not always share the government's objectives. The Deptan representative also thought that NGO participation was very important, but gave no reasons for this. Rony Soerakoesoemah of the ASEAN Secretariat and Prof. Sardjono stated that the private sector should also be encouraged to participate in the negotiations. Soerakoesoemah pointed out that private sector participation has not been a major part of the ASEAN–EU dialogue that has been going on for almost 25 years. This sector's involvement, according to him, could be strengthened and deepened to promote greater trade and investment flows between the two regions. Sardjono also highlighted the importance of private sector participation with regard to IP issues. As IPR owners, commercial enterprises and businesses should protect their rights.

Bureaucratic and civil society groups in the EU

The EU respondents also recognized the importance of NGO participation. Some respondents stated that the EU fully supports engagement and discussion with civil society and would encourage its ASEAN partners to follow suit. NGO participation, it was pointed out, would help raise public awareness and lend transparency to the AEUFTA negotiating process. Respondents suggested that NGOs could participate in broad consultations (e.g., by filling out constructive questionnaires)[156] or civil society dialogues[157] and express their views to decision makers by means of written petitions[158]

150 As articulated by the KADIN representative.

151 As articulated by Rony Soerakoesoemah of the ASEAN Secretariat.

152 As articulated by the Kibar Kediri representative.

153 As articulated by the Bina Desa and Make Trade Fair Indonesia representatives.

154 As articulated by the API and TURC representatives.

155 As articulated by the TURC and KRuHA representatives.

156 As articulated by the representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste.

157 As articulated by the DGTEC representative.

158 As articulated by the ESF representative.

and impact assessments.[159] Two respondents expressed different opinions regarding NGO participation in the actual negotiation process. The DGTEC representative felt that only government officials should be present at the actual negotiations. The Article 133 Cypriot representative, however, felt that civil society and NGOs should get involved in FTA negotiations in order to ensure that human and animal rights and environmental issues are included in the negotiations.

Will the FTA impact positively on both ASEAN and the EU?

Bureaucratic and civil society groups in ASEAN and Indonesia

Of the RI based respondents, only the ASEAN based representatives from Deptan and KADIN felt that the AEUFTA would impact positively on both ASEAN and the EU. The KADIN representative indicated that he was *confident* of a good outcome, citing the many opportunities the FTA will bring to Indonesia in the areas of technology transfer and education. Other state actors were more cautious. Some said it was *too early to say whether the FTA would indeed bring positive impacts*. One respondent even challenged the notion that any benefits arising from this FTA would be seen in the short term. He pointed out that some FTAs take years to generate benefits and that a good result depends on the economies and politics of the parties involved, such as how extensive the trade exchange is and what products ASEAN member states intend to export to the EU. It was even possible, he went on to say, that the FTA may impact negatively on the parties. Although an FTA might increase trade volumes in one area, this might seriously damage another area.

Most of the NGO respondents were only *slightly confident* about the potential positive impacts of the AEUFTA. Two were not at all confident about the positive impacts of the FTA, due to first-hand experience of the grassroots results of trade liberalization. The KRuHA representative pointed out that trade liberalization has had no positive impact with regard to water supplies. Others felt that the asymmetry between ASEAN and the EU meant that the EU might dominate the negotiations. There was also a lack of confidence in the ability of Indonesian state actors to bring about real and positive change for Indonesia, given the state's past record.

Bureaucratic and civil society groups in the EU

EU state actors were *confident* that the AEUFTA would have a positive impact on both ASEAN and the EU. The representative from the EC Delegation to the RI, Brunei Darussalam and Timor Leste referred to two studies commissioned by the EU, stating that the conclusions demonstrated benefits for ASEAN. The Article 133 Cypriot representative explained that both ASEAN and EU investments and exports should increase after the FTA is concluded, although no evidence was given to support this opinion. The Article 133 UK representative thought that the FTA was an excellent opportunity to generate significant economic benefits for both parties, but that this would depend on whether the FTA encompasses all trade and, crucially, tackles both tariff and non-tariff barriers to trade.

The ESF representative was also confident that the FTA would impact positively on services companies in the two regions. He stated that the EU services market is huge and has much growth potential. Today, 98 percent of enterprises in the EU are small and medium-sized enterprises, and he felt that Indonesian companies would be able to find a niche in the EU market, provided these Indonesian companies were organized and ready to compete with their European counterparts. He added that regulatory obstacles

159 As articulated by the representative of the EC Delegation to the RI, Brunei Darussalam and Timor Leste.

are not insurmountable. This confidence depends on two conditions: (1) the negotiations should not last too long; and (2) mutually agreed results should be signed and implemented on a country-to-country basis rather than waiting for the whole of ASEAN to sign up. Citing recent negotiating experiences with the Gulf Cooperation Council and Mercosur, he felt that the negotiations may take longer than he would like. He explained that countries involved in the AEUFTA negotiations should realize the importance of negotiating the FTA as quickly as possible in order to take advantage of the current opportunities available to both parties in the fast paced global environment.

The state actors and the ESF representative also pointed out that the increased competition resulting from the AEUFTA would create problems for ASEAN and/or Indonesian enterprises. However, the Article 133 UK representative stated that while he expected some enterprises to lose out, opportunities would be generated by wider access to markets. This, he hoped, would act as a spur for enterprises to improve their performance and competitiveness. Yet not all EU respondents were optimistic. The Green Party representative stated that the FTA would impact negatively on both regions. The AEUFTA would have a slightly negative impact on EU and ASEAN workers in terms of *real economy development*—i.e., in terms of more people earning a decent living and having work of a more meaningful nature.

On aspirations for the AEUFTA

All respondents were invited to outline their/their organizations' brief and specific aspirations in relation to the future AEUFTA trade negotiations.

Bureaucratic and civil society groups in ASEAN and Indonesia

Among the regional and Indonesia based state and non-state actors, clarity of purpose, caution and detailed study prior to approaching the negotiation table seemed to be the order of the day. Negotiators, they felt, should know what they wanted from the FTA. Regional and national interests should be identified and negotiating positions should be streamlined towards the promotion and protection of these interests. A lack of direction in negotiations, they pointed out, could jeopardize Indonesia's interests, as would a lack of coordination among the different government agencies and a lack of professionalism in government. Long term interests should be pursued and negotiators must resolve to defend Indonesian interests and not be dictated to by their EU counterparts. The *strengths and weaknesses* of the industrial sector and all other sectors, they felt, *must be identified* before any FTA negotiations begin through carrying out studies prior to negotiations. Negotiators must realize that an FTA is all about market access resulting from trade liberalization. NGO respondents hoped that negotiators would be able to establish a real balance between FTA commitments and national interests. Negotiators should weigh up the concerns of all sectors and ensure that the AEUFTA will not operate in such a manner that it *kills* sectors. If need be, government should only make commitments in areas that can take on the challenges of liberalization, leaving out those that are unprepared. One sector should not be sacrificed for another. If the terms of the FTA are biased in the EU's favour, then negotiators should have the political will to terminate negotiations. Negotiators, it was felt, should also consider the implementation of commitments. When any agreement is signed, all parties should comply with their treaty duties and obligations. However, one respondent did point out that if negotiators are aware that Indonesia has had problems implementing commitments in the past, then perhaps now is not the time to make further commitments. The government should acknowledge the nation's strengths and weaknesses and consult the business sector and civil society in order to arrive at a synergized plan of action.

Bureaucratic and civil society groups in the EU

The upcoming FTA negotiations, it was felt, are an opportunity for ASEAN and the EU, providing a unique opportunity to extend the relationship between the two regions. The EU respondents acknowledged that the different levels of development among ASEAN countries must be taken into consideration. Close coordination and preparation were necessary, and technical assistance should be provided. The FTA was predicted to be a very comprehensive agreement and WTO-plus in nature, including dealing with issues such as competition policy and government procurement. As such, the FTA will probably cover goods and the mechanisms to improve transparency. The DGTEC representative stated that transparency would be under discussion, as it is a prominent issue for the EU. Some sectors hoped that the negotiations would be quickly concluded, as *speed was of the essence in this negotiation*. It would be better if the two regions engage in short-term negotiations rather than repeat the negative experience of the EU–Gulf Cooperation Council and EU–Mercosur agreements. The changing nature of globalization today dictates that negotiations should be concluded quickly, with three years being the maximum period for them to last.

Concluding remarks

The trends from the study can be summarized as follows: firstly, all respondents agreed that ASEAN–EU relations, especially in the area of economics and trade, are vital to deepening the relationship between the two regions. Whereas in the past the relationship was driven by political concerns, it should now encompass trade in goods and services, as well as areas such as investment, IPR, competition policy, etc.

Secondly, all respondents agreed that the different levels of development within and among the members of the respective regions should be taken into consideration when negotiating levels of commitment. EU members should recognize that most ASEAN members are still classified as middle income developing countries, while others fall into the category of least developed countries. ASEAN members, on the other hand, should be aware that that the EU's enlarged membership includes countries like Poland and Romania, whose levels of development may be much higher than that of ASEAN countries, but who are still less affluent than the more established members of the EU.

Thirdly, with regard to the *development perspective*, the two regions seem to follow different tracks: the EU prefers extending technical assistance to its partners, places more emphasis on regional integration issues, grants more flexible time frames and pursues a policy of product inclusion. ASEAN interprets *development* as the opportunity to put in place SSMs; the GSP; market access facilitation; subsidies for grassroots level production; a firm commitment to investing in the country (as opposed to simply attracting investors); and the greater participation of civil society and marginal sector organizations in local, regional and national level policymaking.

Fourthly, there is a need for the EU to clarify its policy on market access, which is currently rather confusing for ASEAN producers and manufacturers. On the one hand, the low tariff rates for non-manufactured agricultural products encourage ASEAN exports to the EU. However, before entry to the EU market, these exports are subject to stringent sanitary and phytosanitary standards (which the EU respondents have made clear are WTO-plus). Furthermore, assuming that this produce does pass the sanitary and phytosanitary standards, it is then forced to compete with heavily subsidised domestic goods in the EU market. On the other hand, if an ASEAN member chooses to export manufactured products, they are subject to very high tariff rates. This is a significant handicap, which can price ASEAN members' products out of the EU market.

Fifthly, in relation to the previous point, ASEAN and the EU also need to clarify if the aim of the proposed AEUFTA is to encourage ASEAN members to remain low level producers (i.e., producers of raw materials and agricultural products) or to encourage the development of ASEAN's manufacturing industries. If tariff peaks remain unaddressed, one cannot fault ASEAN for thinking that perhaps EU trade policy is designed to keep its ASEAN partners as nations of farmers and fishers rather than manufacturers.

Sixthly, with regard to the GSP, the prediction made by the representative from the Thai Embassy may already be coming true. A new GSP scheme was adopted on 27 June 2005, through Council Regulation (EC) no. 980/2005, covering the period 1 January 2006 to 31 December 2008. In Annex I of this document, the following products exported by Indonesia no longer enjoy the privileges granted under the GSP:[160] (1) animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes; and (2) wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basket ware; and wickerwork.

Seventhly, the DGTEC respondent claimed that multilateral forums are the best places to discuss agricultural subsidies (a point that was reiterated by her colleague from the EC Delegation to the RI, Brunei Darussalam and Timor Leste). On the other hand, the same respondent claimed that the AEUFTA, a region-to-region agreement aiming to encompass the issue of agricultural subsidies, would definitely benefit both sides.

Eighthly, the disparity with regard to the level of awareness surrounding government procurement issues should be flagged. The ASEAN respondents gave short or no answers to questions on government procurement, in contrast to their lengthy and often elaborate replies to other questions. In comparison, their EU counterparts seemed very knowledgeable about government procurement. ASEAN, and indeed Indonesian, negotiators must endeavour to correct the disparity in this area, in anticipation of the EU services sector's push to liberalize the government procurement sector.

Ninthly, there was also a disparity in the level of awareness about services sector liberalization issues. There is no leading services or labour oriented NGO in Indonesia to compare to the ESF. Efforts in this area could therefore lack organization. The absence of replies from the ASEAN respondents regarding this issue indicates a low level of awareness when compared with their European counterparts. This is a cause for concern, as it was made clear by almost every European stakeholder consulted that services, rather than trade, will be pushed in the AEUFTA agenda. ASEAN, and Indonesia in particular, run the risk of finding themselves dealing with European counterparts who are more knowledgeable and experienced in this area. This is a truly serious concern.

Tenthly, there is scope for cooperation between governments and members of the private, academic and civil society sectors in both ASEAN and the EU preparing for the upcoming negotiations. The private sector respondents agreed that governments may not have the resources to cover all the areas that the proposed AEUFTA will likely include in its provisions. As such, assistance from more knowledgeable sectors should be sought.

Finally, business and civil society respondents seem to be under the impression that the government of Indonesia is ill prepared for the negotiations. This viewpoint is based on the past performance of government negotiators in other FTA negotiations. The respondents thus felt that a well researched and strategic approach should be agreed *prior* to negotiations, especially on the part of the government.

160 Council Regulation (EC) no. 980/2005, Annex I, L 169/15.

Chapter 6 – Conclusion

Introduction

There can be little doubt that the proposed FTA between ASEAN and the EU is likely to bring significant challenges to the countries of Southeast Asia. The AEUFTA can be expected to deepen the existing asymmetry of economic relations between the two blocs. The developing and least developed countries of ASEAN in particular are likely to face economic difficulties as a result of the adjustment costs generated from this trade agreement. Despite warnings about and criticism of the proposed AEUFTA, there is little chance that ASEAN and the EU will postpone the impending trade negotiations. Given these circumstances, it is imperative that the proposed AEUFTA should take into account ASEAN countries' development objectives .

The EU today has become an economic entity capable of exercising influence beyond that of other global economic superpowers. ASEAN, on the other hand, has yet to evolve into a supranational economic entity capable of competing with the EU on the world stage. Regional integration among ASEAN member countries remains weak, despite the ASEAN Charter, which was signed during the Thirteenth ASEAN Summit in Singapore in November 2007. Ideally, this study argues that an FTA between the two regional blocs should be pursued only after the member countries of ASEAN become capable of fully transforming themselves into one integrated bloc. In other words, ASEAN should concentrate its efforts on establishing an ASEAN Community by 2015, instead of pursuing bilateral free trade initiatives.

For Indonesia in particular, the adjustment costs resulting from the proposed AEUFTA, especially in the short term, will severely affect the welfare of its people. As a relatively reluctant free trader in the past, Indonesia now actively pursues trade and investment liberalisation initiatives. ASEAN is responsible for several regional liberalization initiatives (e.g., the AFTA, the AIA and so on) and three BFTAs (with China, Japan and South Korea). The people of Indonesia, like the people of other Southeast Asian nations, were promised that ASEAN economic integration would be used as the training ground for further integration into the global economy at a later stage. The realization of the AEC is still six years away, and the economies of the developing and least developed countries of ASEAN, including Indonesia, are far from becoming experienced in economic integration. These countries find themselves forced to make significant adjustments to accommodate bilateral, interregional and global level liberalization. The consequences of such liberalization are likely to affect the overall developmental objectives of Indonesia and other developing and least developed ASEAN members. In this conclusion, we aim to highlight some of the key concerns and recommendations related to the AEUFTA as an international trade strategy for both ASEAN and Indonesia.

Main concerns and recommendations

We would like to highlight a number of issues in relation to the intention of ASEAN and the EU to pursue an FTA. To start with, our quantitative analysis shows that neither a 10 percent expansion of the EU's FDI into Indonesia (scenario 1) nor an 18.5 percent increase of Indonesian exports to Europe (scenario 2) generate worthwhile gains for the Indonesian economy. In the first scenario, capital inflows from the EU into Indonesia could, in fact, be expected to reduce the welfare of Indonesians as a result of intense competition from EU investment in Indonesia. Although real investment in Indonesia and the country's exports to the EU grow by 0.99 percent and 2.65 percent, respectively, which leads to a

1.16 percent increase in national GDP, a 0.89 percent increase in employment and a 1.53 percent increase in capital, household expenditure or consumption can expect to fall by 0.11 percent if there are no capital inflows from the EU. In the long run, the AEUFTA is likely to generate larger gains for the EU than for Indonesia. Economic actors in Indonesia are more likely to supply domestic demand and are expected to generate a relatively small increase in Indonesian exports to the EU. Moreover, employment growth in Indonesia will not be enough to counteract the loss of profits in businesses owned by Indonesian economic actors once there is more competition from their EU counterparts. This condition would causes an overall decline in the welfare of Indonesians.

In the second scenario, where Indonesian exports to the EU grow by 18.5 percent, our quantitative study reveals two important outcomes. The first shows that there are some sectors and provinces in Indonesia that will benefit, while others will lose out. The second shows that the AEUFTA is likely to make a minimal contribution to the national GDP. Although the 18.5 percent increase in Indonesian exports to the EU will generate a positive long term effect, such as an increase in labour productivity, household income and thus the overall welfare of Indonesians, it generates an increase of 0.48 percent in Indonesian household consumption. Our sectoral results in the second scenario also show that due to stiff overseas and intra-industry competition, exports linked to sectors such as forestry, fisheries, paper, chemicals, petrol refineries, LNG, other manufactures, hotels and restaurants, transport and communications, finance, government and defence, education, and other services can be expected to lose out under the AEUFTA. It is also important to bear in mind that an assumed 18.5 percent increase in Indonesian exports to the EU is rather optimistic and the actual increase is likely to be much lower. Although export growth to the EU increases household welfare in the long run, this growth will make little difference to the national GDP. In spite of the minimal economic benefits, the second scenario yields much better results than the first.

The AEUFTA should prioritize the developmental objectives of ASEAN members. As pointed out in Chapter 5, ASEAN and the EU seem to define the end goal of *development* in different ways. The EU prefers to extend technical assistance to its partners, places more emphasis on regional integration issues, grants more flexible time frames for the implementation of an FTA, and pursues a policy of product inclusion. ASEAN, on the other hand, prefers to use SPMs and SSMs, the GSP, and market access facilitation. It also allows subsidies for grassroots level production, is firmly committed to investing in the Southeast Asian region (as opposed to the *mere potential* of attracting investors), and encourages the greater participation of civil society and marginal sector organizations in local, regional and national level policymaking processes.

In the authors' opinion, a number of factors are crucial to the AEUFTA negotiations. These include taking into account ASEAN's end goal definition of development and some aspects of the EU's (particularly in relation to technical assistance), strengthening regional integration, and establishing a flexible time frame, which would allow Indonesian economic actors to manage better the adjustment costs derived from this FTA, for the conclusion of both the negotiations and the implementation of an FTA. The use of SPMs and SSMs must be justified in the AEUFTA, as they can act as guarantees to ensure the sustainability of items or products deemed sensitive by ASEAN economic actors. Many ASEAN member countries are still coping with the challenges posed by trade liberalization in general. Permitting the use of SPMs and SSMs would be a goodwill gesture on the EU's part to demonstrate that the motives behind the AEUFTA are not to achieve EU economic domination.

The EU must also expand its GSP schemes to ASEAN developing and least developed countries and ensure that ASEAN products exported to the EU are given greater market access. As highlighted in

Chapter 3, the GSP plays a significant part in the EU's external trade policy options. This scheme aims to simplify and harmonize procedures in order to improve the access of developing and least developed countries to the EU market. Given the limited capability of economic actors, particularly small and medium-sized ones, to carry out operations beyond national and/or regional borders, the EU's present GSP policy vis-à-vis ASEAN countries must be made more favourable to ASEAN members. In the context of Indonesia, as of June 2005 the country had 'graduated' from the EU's GSP scheme, and this has limited a range of the country's products, such as wood products, vegetables fats and so on, from enjoying low tariffs or duty free access to the EU market. The EU's ability to reassess its GSP policy vis-à-vis Jakarta would help to balance the asymmetric economic relationship between the two sides.

Chapter 5 also stressed the need for the EU to clarify its policy on market access and subsidies. The EU's current policies are confusing for many producers and manufacturers in the ASEAN region. On the one hand, low tariff rates for non-manufactured agricultural products give the impression that the EU encourages the export of ASEAN produce to its markets. However, ASEAN producers and manufacturers often complain that once these exported products are at the EU border, they are hit by a range of stringent sanitary and phytosanitary measures that impede them from further penetrating the EU market. At this point in the distribution chain, ASEAN producers find themselves in the disadvantageous situation of having already incurred costs transporting their produce to Europe but not having a market to sell their goods to. Furthermore, assuming this produce does pass these WTO-plus sanitary and phytosanitary standards, they are forced to compete with heavily subsidized domestic goods. On the other hand, if an ASEAN exporter chooses to export manufactured products, these are normally hit by high tariff rates—a significant handicap that can effectively price ASEAN goods out of the EU market.

In relation to this, both ASEAN and the EU also need to clarify whether the AEUFTA *aims to encourage ASEAN members to remain low level producers (e.g., of raw materials and agricultural products) or to encourage the development of manufacturing industries in the Southeast Asian region. If the issue of tariff peaks remains unresolved, one could forgive ASEAN for thinking that perhaps it is the trade policy of the EU to keep its ASEAN partners as farmers and fishers rather than manufacturers*. Furthermore, the issue of subsidies needs to be addressed in the AEUFTA. While the continuous use of large agricultural subsidies in the EU remains a matter of concern among ASEAN agricultural exporters, the use of subsidies for small scale or grassroots producers might still be a useful tool to ensure the welfare of ASEAN farmers.

With regard to foreign investment, the AEUFTA must do more than just create the mere potential for foreign investment. It must secure a *concrete commitment from both sides to invest in the two regions*. Most mainstream studies, such as Kettunen (2004) and one that was commissioned by the European Commission (Consortium Euro-Asia Centre and IFRI, 2006), promise that an FTA between the EU and ASEAN would increase the flows of European investment to ASEAN, including Indonesia. However, there are non-economic factors, such as security, that may influence the flows of foreign investment to Southeast Asia. The AEUFTA, therefore, must secure a concrete commitment from both Brussels and Jakarta to invest in the two regions. While foreign investment is acknowledged to be the 'prime mover of the development process', *this promise remains a pipedream if no real capital investment flows to the regions*, particularly to ASEAN. Any conditions laid out by the EU that aim to liberalize foreign investment laws in the ASEAN region must be met by a concomitant concrete undertaking that significant foreign investment ensues in the form of long term capital flows from major European manufacturers. The EU, for instance, could assist and facilitate the promotion of Indonesian market opportunities to European investors and develop appropriate measures with Jakarta to determine how the 'right types' of investment could be expanded in Indonesia. In the absence of this concrete undertaking, the AEUFTA will be no different from the current crop of FTAs that strip countries of their policy space and leave their industries wide open for exploitation by foreign opportunists.

Finally, the importance of civil society and marginal sectors in the AEUFTA policymaking process cannot be overemphasized. These sectors provide crucial alternative inputs to policymakers seeking a beneficial trade agreement between ASEAN and the EU. As a large democratic entity, the EU should be able to influence ASEAN so that the AEUFTA reflects the opinions and aspirations of not only large economic actors, but also civil society. While some ASEAN member countries, such as Indonesia, have relatively participative trade decision making process, others are still plagued by a democratic deficit. If possible, a public referendum should be held to take into account a wider range of opinions about such a significant trade arrangement. The EU must also respect the issue of democratic governance. Some studies, such as that of Chandra (2007), conclude that while large democracies such as the U.S. and EU promote global democracy, their attitude towards public participation in trade decision making processes is often undemocratic. Trade negotiations, which are likely to affect many sectors of society, must be kept open, transparent and accountable to public scrutiny. It is better to have lengthy consultations at the national and regional levels than to ignore the possible impacts of trade on, for example, society and the environment.

Concluding remarks

In conclusion, the AEUFTA is likely to deepen the asymmetry of economic relations between ASEAN and the EU, particularly if ASEAN's developmental objectives are ignored in the process of negotiations and implementation. ASEAN can certainly benefit from this trade agreement if the EU is willing to (1) allow the use of SPMs/SSMs; (2) expand its existing GSP scheme; (3) improve market access facilitation for ASEAN's exports to the EU; (4) allow the use of subsidies for low level agricultural producers; (5) provide a concrete commitment to long term capital investment in ASEAN countries; (6) agree to the use of very flexible time frames for the conclusion and implementation of the AEUFTA; and (7) ensure the participation of civil society groups in the AEUFTA policymaking processes. However, the rigidity of the EU's position in multilateral trade negotiations is a clear indication of how difficult it will be to impose such measures. Although there will be some political gains from this proposed arrangement, ASEAN policymakers must think carefully before committing to a free trade arrangement with one of the most powerful regional groupings in the world. What is important for ASEAN now is to focus on deepening its own economic regionalism, i.e., ASEAN member countries need to concentrate on domestic reforms prior to engaging fully in a bilateral FTA with the EU. It is only after such objectives have been met that the AEUFTA should be pursued.

Appendix 1 – Cooperation Agreement between Member Countries of ASEAN and the European Community, Kuala Lumpur, 7 March 1980

CONSCIOUS that such cooperation will be between equal partners but will take into account the level f development of the member countries of ASEAN and the emergence of ASEAN as a viable and cohesive grouping, which has contributed to the stability and peace in Southeast Asia;

PERSUADED that such cooperation should be realised in an evolutionary and pragmatic fashion as their policies develop;

AFFIRMING their common ill to contribute to a new phase of international economic cooperation and to facilitate the development of their respective human. and material resources on the basis of freedom, equality and justice;

HAVE DECIDED to conclude a Cooperation Agreement and to this end have designated as their plenipotentiaries;

WHO having exchanged their full powers, found in good and due form;

HAVE AGREED AS FOLLOWS:

ARTICLE 1
Most-Favoured-Nation Treatment

The Parties shall, in their commercial relations, accord each other most-favoured-nation treatment in accordance with the provisions of the General Agreement on Tariffs and Trade, without prejudice, however, to the provision of the Protocol annexed to this Agreement.

ARTICLE 2
Commercial Cooperation

1. The Parties undertake to promote the development and diversification of their reciprocal commercial exchanges to the highest possible level taking into account their respective economic situations.

2. The Parties agree to study ways and means of overcoming trade barriers, and in particular existing non-tariff and quasi tariff barriers, taking into account the work of international organisations;

3. The Parties shall in accordance with their legislation and in the conduct of their policies:

   (a) cooperate at the international level and between themselves in the solution of commercial problems of common interest including trade related to commodities;

   (b) use their best endeavours to grant each other the widest facilities for commercial transactions;

   (c) take fully into account their respective interests and needs for improved access for manufactured, semi manufactured and primary products as well as the further processing of resources;

(d) bring together economic operators in the two regions with the aim of creating new trade patterns;

(e) study and recommend trade promotion measures likely to encourage the expansion of imports and exports;

(f) seek insofar as possible the other Parties—views where measures are being considered which could have an adverse effect on trade between the two regions.

ARTICLE 3
Economic Cooperation

1. The Parties, in the light of the complementarity of their interests and of their long-term economic capabilities, shall bring about economic cooperation in all fields deemed suitable by the Parties. Among the objectives of such cooperation shall be:

   - the encouragement of close, economic links through mutually beneficial Investment;

   - the encouragement of technological and scientific progress;

   - the opening up of new sources of supply and new markets;

   - the creation of new employment opportunities.

2. As means to such ends, the Parties shall, a, appropriate, encourage and facilitate inter alia:

   - a continuous exchange of information relevant to economic cooperation as well as the development of contacts and promotion activities between firms and organisations in both regions;

   - the fostering, between respective firms, of industrial and technological cooperation, including mining;

   - cooperation in the fields of science and technology, energy, environment, transport and communications, agriculture, fisheries and forestry.

   In addition the Parties undertake to improve the existing favourable investment climate inter alia through encouraging the extension, by and to all Member States of the Community and by and to all member countries of ASEAN, of investment promotion and protection arrangements which endeavour to apply the principle of non-discrimination, aim to ensure fair and equitable treatment and reflect the principle of reciprocity.

3. Without prejudice to the relevant provisions of the Treaties establishing the Communities, this Agreement and any action taken thereunder shall in no way affect the powers of any of the Member States of the Communities to undertake bilateral activities with any of the member countries of ASEAN in the field of economic cooperation and conclude, where appropriate, new economic cooperation agreements with these countries.

ARTICLE 4
Development Cooperation

1. The Community recognises that ASEAN is a developing region and will expand its cooperation with ASEAN in order to contribute to ASEAN's efforts in enhancing its self-reliance and economic resilience and social well-being of its peoples through projects to accelerate the development of the ASEAN countries and of the region as a whole.

2. The Community will take all possible measures to intensify its support, within the framework of its programmes in favour of non associated developing countries, for ASEAN development and regional cooperation.

3. The Community will cooperate with ASEAN to realise concrete projects and programmes, inter alia, food production and supplies, development of the rural sector, education and training facilities and others of a wider character to promote ASEAN regional economic development and cooperation.

4. The Community will seek a coordination of the development cooperation activities of the Community and its Member States in the ASEAN region especially in relation to ASEAN regional projects.

5. The Parties shall encourage and facilitate the Promotion of cooperation between sources of finance in the two regions.

ARTICLE 5
Joint Cooperation Committee

1. A joint Cooperation Committee shall be set up to Promote and keep under reviews the various cooperation activities envisaged between the Parties in the framework of the Agreement. Consultations shall be held in the Committee at an appropriate level in order to facilitate the implementation and to further the general aims of this Agreements. The Committee will normally meet at least once a year. Special meetings of the Committee shall be held at the request of either Party.

2. The Joint Cooperation Committee shall adopt its own Rules of Procedure and programme of work.

ARTICLE 6
Other Agreements

Subject to the provisions concerning economic cooperation in article 3(3), the provisions of this Agreement shall be substituted for provisions of Agreements concluded between Member States of the Communities and Indonesia, Malaysia, Philippines, Singapore and Thailand to the extent to which the latter provisions are either incompatible with or identical to the former.

ARTICLE 7
Territorial Application

This Agreement shall apply, on the one hand, to the territories in which the Treaty establishing the European Economic Community is applied and under the conditions laid down in that Treaty and, on the other hand, to the territories of Indonesia, Malaysia, Philippines, Singapore and Thailand.

ARTICLE 8
Duration

1. This Agreement shall enter into force on the first day f the month following the date on which the Parties have notified each other of the completion of the procedures necessary for this purpose, and shall remain in force for an initial period of five years and thereafter for periods of two years subject to the right of either Party to terminate it by written notice given six months before the date of expire of any period.

2. This Agreement may be amended by mutual consent of the Parties in order to take into account new situations.

ARTICLE 9
Authentic Languages

This Agreement is drawn up in seven originals in the English, Danish, Dutch, French, German and Italian languages. Each of these texts being equally authentic.

IN WITNESS WHEREOF the undersigned Plenipotentiaries have signed this Agreement.

DONE at Kuala Lumpur on the seventh day of March in the year one thousand nine hundred and eighty.

1. According to the provisions of the protocol the European Economic Community and a party that is not a contracting party of the General Agreement on tariffs and trade shall, with regard to imported or exported foods, grant each other most-favoured nation treatment in all matters relating to:

   - customs duties and charges of all kinds including the procedures for collecting such duties and charges;

   - regulations concerning customs clearance, transit, warehousing or transhipment;

   - direct or indirect taxes and other internal charges;

   - regulations concerning payments including the allocation of foreign currency and the transfer of such payments;

   - regulations affecting the sale, purchase, transport, distribution and use of goods on the internal market.

2. Paragraph 1 shall not apply to:

   (a) advantages granted to neighbouring countries to facilitate frontier one traffic;

   (b) advantages granted with the object of establishing a customs union or a free trade area or as required by such a customs union or force trade area;

(c) advantages granted to particular countries in conformity with the General Agreement on Tariffs and Trade;

(d) advantages which the member countries of the Association of the Southeast Asian Nations grant to certain countries in accordance with the Protocol on Trade Negotiations among Developing Countries in the content of the General Agreement on Tariff and Trade;

(e) advantages granted or to be granted within the framework of ASEAN provided these do not exceed those that are granted or may be granted within the framework of ASEAN by member countries of ASEAN which are contracting parties of the General Agreement on Tariffs and Trade.

Source: ASEAN Secretariat (1980)

Appendix 2 – Recommendation from the Commission to the Council and Annex

Authorising the Commission to negotiate a free trade agreement with countries of the Association of South East Asian Nations (ASEAN)[162] on behalf of the European Community and its Member States

1. EXPLANATORY MEMORANDUM

1. BACKGROUND

1.1. EU Policy on Free Trade Agreements

The Commission's Communication 'Global Europe: competing in the world'[163] reviewed the contribution of EU trade policy to the European Growth and Jobs Strategy. It confirmed the EU's commitment to the World Trade Organisation (WTO) as the single most effective means of expanding and managing trade for the benefit of all. It stressed that the Doha Development Agenda (DDA) remains the EU's first priority and that we will work hard to resume negotiations. The Communication also argued that the EU should build on the platform created by the WTO to generate new opportunities for growth by opening markets further to trade and investment. The Communication set out a series of linked trade policy initiatives complementing efforts to resume negotiations in the WTO. As part of these initiatives, it proposed to negotiate carefully chosen comprehensive Free Trade Agreements (FTAs).

FTAs, if approached with care, can go further and faster in promoting openness and integration, by tackling issues which are not ready for multilateral discussion. The Communication stressed that we should continue to factor in other issues and the wider role of trade policy in EU external relations into bilateral trade developments. But in order for trade policy to help create jobs and drive growth, economic factors must play a primary role in the choice of future FTAs. The key economic criteria for new FTA partners should be market potential (economic size and growth) and the level of protection against EU export interests (tariffs and non-tariff barriers), while taking account of our potential partners' negotiations with EU competitors.

In terms of content, new competitiveness-driven FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalisation, including far-reaching liberalisation of services and investment. Future FTAs would also need new ways of addressing non-tariff barriers and incorporating provisions on trade-related aspects of sustainable development.

The Communication stresses the need to ensure that we share similar ambitions with our prospective partners at the outset in order to avoid negotiations later stalling due to a mismatch of expectations. On 13 November 2006, the Council of the European Union concluded that it supports the early launch of negotiations with countries of the Association of South East Asian Nations (ASEAN), India, and the Republic of Korea (hereafter referred to as Korea), and invited the Commission to submit proposals for the negotiating directives without delay.

162 Consultations are ongoing with ASEAN on the architecture of the FTA negotiations. Upon conclusion of these consultations and prior to the adoption of this recommendation, the Commission will present its proposal concerning the countries with which negotiations should be launched.

163 COM(2006) 567, 'Global Europe: competing in the world,' 4 October 2006.

1.2. EU–ASEAN Relations

The relationship between the European Union and the member countries of ASEAN is an important and longstanding one, with the existing Co-operation Agreement between the EC and certain member countries of ASEAN dating from 1980. In July 2003, the European Commission adopted a Communication on a 'New Partnership with South East Asia', setting out a comprehensive strategy for future BIJ relations with the countries of the region and, in particular, recognising the need to initiate a new dynamism into trade and investment relations on a regional basis.

A key initiative was proposed within this strategy, the ongoing trade action plan, known as the *Trans-Regional EU–ASEAN Trade Initiative (TREATI)*, which reflects the desire of all partners to expand trade and investment ties and has provided a framework for dialogue and regulatory co-operation on various trade facilitation, market access, and investment issues between the two regions, and increasingly also acting as a forum for the exchange of experience on regional economic integration.

On the bilateral level, negotiations for bilateral Partnership and Co-operation agreements are well underway with Thailand and Singapore, and have started with Indonesia. Malaysia, the Philippines, and Brunei have also shown an interest. Vietnam is keen to upgrade its existing agreement into a more comprehensive political framework. The intention is to establish such agreements with all of the interested countries in the region as soon as possible.

While these are important and significant steps, it is dear that recent rapid developments in the Asian region as a whole notably the progress of ASEAN's own economic integration and the establishment of a vast network of new free trade agreements with ASEAN at its hub, demand a strong response from the EU. This response must demonstrate our desire for a much more substantive and comprehensive economic engagement with ASEAN, providing a vehicle to increase our market access to a rapidly expanding and developing region, commensurate with the EU's position as ASEAN's third largest trading partner.

The thrust of the existing agreements and ongoing negotiations is rather on the political side and trade aspects need to be further reinforced. European industry has expressed an urgent request in light of the preferential market access being provided to its competitors and in order to exploit more effectively new economic opportunities with one of the most dynamic regions in the world. A comprehensive economic and political approach will strengthen Europe's position and influence in Southeast Asia.

Furthermore, as these countries continue to develop economically, the impact of non-tariff barriers on our trade is growing and the need for a more robust framework to resolve such issues will become even more urgent. The establishment of a free trade area provides an additional incentive for ASEAN countries both to profit from our experience and identify solutions and approaches which are more compatible with those of the EU.

2. NATURE AND SCOPE OF THE AGREEMENT

A comprehensive FTA with the countries of ASEAN should aim to improve market access for goods and services, covering substantially all trade. It should provide for enhanced provisions on trade in goods and services and include binding provisions on regulatory transparency in areas relevant for mutual trade and investment, including standards and conformity assessment, sanitary and phytosanitary rules, intellectual property rights including enforcement, trade facilitation and customs, public procurement, and trade and competition, including state aid. It should also provide for co-operation on trade and sustainable development, including both its environmental and social dimensions.

In going above and beyond the existing commitments in the WTO, the FTA should be fully WTO-compliant, in particular, with Article XXIV of the General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS).

The relationship between the FTA provisions and the Partnership and Co-operation provisions will require further examination prior to the conclusion of the agreements.

This approach is in line with the 'Global Europe' strategy, which underlines that new competitiveness-driven FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalisation, including far-reaching liberalisation of services and investment.

3. PREPARATION OF THE DRAFT NEGOTIATING DIRECTIVES

Consultations with Member States, EU institutions, civil society (including European business) and ASEAN countries have taken place for the preparation of the draft negotiating directives, as well as for the accompanying impact assessment. These consultations were undertaken in the context of the future orientations for EU trade policy, the related adaptation of its FTA strategy, and the specific prospects for an FTA with ASEAN countries.

Consultations with ASEAN are still ongoing with regard to the architecture of the FTA, taking into account the diversity in the economic situation of ASEAN members. The Commission will inform the Council of the results of these consultations prior to the adoption of the negotiating directives, including its proposal with regard to the ASEAN countries with whom to launch negotiations.

The Commission has drafted an impact assessment which analyses the possible impact of an FTA with ASEAN countries. A more detailed Sustainability Impact Assessment (STA) examining the Agreement's potential economic, social, and environmental effects will be conducted in parallel to the negotiations.

4. PROCEDURES

The objective is to complete these negotiations no later than two years after their effective start. In line with normal practice, the Commission will report regularly to Member States in the appropriate committees of the Council on progress in the negotiations. When negotiations are more advanced, the Commission will make an assessment of how to proceed, including the option of bilateral negotiations with ASEAN countries, in coherence with PCA negotiations, if it is not possible to conclude negotiations at a regional level.

5. RECOMMENDATION

In light of the above, the Commission recommends that:

- The Council authorises the Commission to negotiate a Free Trade Agreement with countries of the Association of South East Asian Nations (ASEAN);
- The Council appoints a special Committee (133) to assist it in this task;
- The Council issues the attached negotiating directives.

Annex: Directives for the negotiation of a free trade agreement between the European Community and its member states and countries of the Association of South East Asian Nations (ASEAN)

NATURE AND SCOPE OF THE AGREEMENT

The Free Trade Agreement (FTA) will exclusively contain trade provisions applicable between the parties. Other issues will be regulated under the existing cooperation agreements or in the non-trade provisions of future Partnership and Cooperation Agreements (PCAs) with the countries concerned. The legal .relationship between the free trade provisions and the PCAs or other co-operation agreements will be decided prior to their conclusion.

2. The Agreement shall be comprehensive, balanced, and fully consistent with World Trade Organisation (WTO) rules and obligations.

3. The Agreement shall provide for the progressive and reciprocal liberalisation of trade in goods and services as well as rules on trade-related issues.

PREAMBLE AND GENERAL PRINCIPLES

4. The preamble will indicate that the partnership between the European Community (EC) and countries of ASEAN is based upon common principles and values, and will refer, inter alia, to:

   - The commitment of the parties to sustainable development and the contribution of international trade to sustainable development in its economic, social and environmental dimensions, including economic development, poverty reduction, full and productive employment and decent work for all, as well as the protection and sustainable use of eco-systems and natural resources;

   - The commitment of the parties to an FTA in full compliance with their rights and obligations arising out of the WTO;

   - The right of the parties to take measures necessary to achieve legitimate public policy objectives on the basis of the level of protection that they deem appropriate, provided that such measures do not constitute a means of unjustifiable discrimination or a disguised restriction of international trade;

   - The belief that the FTA will create a new climate for trade relations between the two parties and above all for the development of trade and investment;

   - The commitment of the parties to communicate with all relevant interested parties including the private sector and civil society organisations.

TITLE 1: OBJECTIVES

5. The Agreement shall confirm the joint objective of progressively and reciprocally liberalising substantially all trade in goods and services, in full compliance with WTO rules.

6. The Agreement will recognise that sustainable development is an overarching objective of the parties and will aim at ensuring and facilitating respect of international environmental and social agreements and standards. The Agreement will recognise that the parties shall not encourage foreign direct investment by lowering domestic environmental, labour or occupational health and safety legislation and standards, or by relaxing core labour standards or laws aimed at protecting and promoting cultural diversity.

   The Agreement's economic, social and environmental impacts will be examined by means of an independent Sustainability Impact Assessment (SIA), which the Commission shall undertake in parallel with the negotiations and which will be finalised ahead of the signature of any final Agreement. The SIA will aim to clarify the likely effects of the Agreement on sustainable development on both sides as well as to propose measures (trade or non trade) to maximise the benefits of the Agreement and prevent or minimise potential negative impacts. There will be a specific chapter of the Agreement on trade and sustainable development, including both social and environmental issues, and addressing such measures. Sustainable development will also be taken into account throughout the Agreement.

TITLE 2: TRADE IN GOODS

7. Duties on imports and exports and non-tariff measures

   The aim of the Agreement will be to dismantle import duties and charges having an equivalent effect on both sides over a period of time not exceeding 10 years, with a view to offering similar market access opportunities on both sides at the end of this period. Taking into account their different levels of development, ASEAN countries will have a certain measure of flexibility as regards transitional periods. The Agreement will cover substantially all trade in goods between the parties. The aim will be to ensure the highest possible degree of trade liberalisation.

   The basic duties to which reductions are to be applied shall be those applied by the Community erga omnes on the day before signature of the Agreement and the external tariff applied by each ASEAN country erga omnes on the day before signature of the Agreement.

   GSP preferences currently applied by the European Community to products originating in ASEAN countries shall be covered in the Agreement. Simultaneously, ASEAN beneficiary countries shall be withdrawn from the list of countries benefiting from Regulation No 980/2005 (GSP Regulation).

8. The Agreement shall provide for a maximum of frontloading of full liberalisation commitments, taking into account the importance of ensuring to the maximum extent feasible panty with FTAs being negotiated with other major trading partners, as well as the different levels of development of ASEAN countries.

9. Specific provisions will regulate products identified as sensitive, for which for instance, longer transitional periods or partial liberalisation commitments with a review clause will be foreseen. Any such specific provisions or treatment will be kept to a minimum, in terms of both tariff lines and value of trade between the parties. For products not subject to full liberalisation commitments, following the application of the Agreement, a clause will consider possibilities for further liberalisation.

10. The Agreement will forbid any ban, restriction or other non-tariff barrier (NTB) to trade which is not justified by the general exceptions set out below, and which could amount to a means of arbitrary discrimination or a disguised restriction on trade between the parties. Provisions and procedures will be included to ensure the elimination of unjustified non-tariff obstacles to trade. The Agreement will contain provisions concerning the prohibition of fiscal discrimination. Product-specific NTBs may be solved on a request and offer basis, in parallel with exchanges on tariff concessions. Where relevant to further the objectives of the Agreement and to improve market access at a level which cannot be achieved sufficiently through horizontal rules, the Agreement should include sector specific commitments on NTBs. The Agreement will also envisage appropriate domestic procedures to prevent NTBs and other unnecessary obstacles to trade, including through transparency in regulations.

11. All customs duties, taxes or charges on exports and quantitative restrictions on exports to the other party which are not justified by exceptions under the Agreement shall be abolished upon the application of the Agreement.

12. Rules of origin

    A protocol setting out simple and development-friendly rules of origin to be applied and providing for administrative co-operation will be annexed to the Agreement. The protocol will be based on the orientations of the Commission Communication of 16 March 2005 entitled 'The rules of origin in preferential trade arrangements'.

13. Anti-fraud measures

    A clause in the Agreement concerning enhanced administrative co-operation will set out the procedures and appropriate measures that the parties may take where a lack of administrative co-operation in customs matters, irregularities or fraud are established.

14. Financial responsibility

    Provisions should also be included to examine jointly the possibility of adopting appropriate measures in case of errors committed by the competent authorities in the application of the preferential rules of origin, where such errors would lead to consequences in terms of import duties.

15. Technical regulations on industrial products, standards and conformity assessment procedures

    The Agreement will refer to a number of general principles (such as proportionality, no undue restrictions, transparency, non-discrimination) to be applied by the parties in their mutual trade. Apart from confirming the provisions of the WTO Agreement on Technical Barriers to Trade, the parties shall also establish provisions that facilitate access to each others' markets. The aim will be to include provisions on the adoption of recognised international standards and on the streamlining of testing requirements in a number of priority sectors. The Agreement will also aim at improving dissemination of information to importers and exporters, developing common views and promoting good regulatory practice, seeking compatibility and convergence of technical regulations, promoting close co-operation with and between relevant organisations responsible for standardisation and accreditation.

16. Sanitary and phytosanitary measures

On sanitary and phytosanitary measures, the conditions negotiated shall follow the provisions of the negotiating directives adopted by the Council on 20 February 1995 (Council document 4976/95). Furthermore, the Agreement will refer to a number of general principles of the WTO Agreement on Sanitary and Phytosanitary Measures, including proportionality, undue delays, transparency, and non-discrimination, to be applied by the parties in their mutual trade, with the objective of facilitating access to each other's market while safeguarding public animal and plant health.

The Agreement should in particular seek to achieve full transparency as regards sanitary and phytosanitary measures applicable to trade, work towards the establishment of a mechanism for recognition of equivalence including the prelisting of food-producing establishments, and work towards recognition of the disease-free health status of the parties and the principle of regionalisation for both animal and plant diseases, while maintaining essential minimal cheeks at the external border. Animal welfare shall be within its scope.

17. General exceptions

The Agreement will include a general exception clause based on Articles XX and XXI of the GATT.

18. Safeguards

To maximise liberalisation commitments, the Agreement will contain a bilateral agricultural safeguard clause by which either party may restore Most Favoured Nation duties where a rise in imports of a product from the other party is causing or threatening to cause serious injury to its domestic industry.

19. Anti-dumping and countervailing measures

The Agreement will include a clause on anti-dumping and countervailing measures providing that any of the parties may take appropriate measures against dumping and/or countervailable subsidies in accordance with the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 or the WTO Agreement on Subsidies and Countervailing Measures. The Agreement will also integrate commitments that go beyond WTO rules in this area in line with EC rules and previous agreements (e.g., public interest test and lesser-duty rule, additional consultations).

TITLE 3: TRADE IN SERVICES, ESTABLISHMENT

20. The Agreement shall provide for the progressive and reciprocal liberalisation of establishment and of trade in services with the aim to ensure a high level of market access opportunities, consistent with the relevant WTO rules, in particular Article V of the GATS.

Taking into account their levels of development, ASEAN countries will be allowed a certain measure of flexibility in overall terms as well as in individual sectors and subsectors. Any transitional period should in principle not exceed 10 years.

While respecting Article V of the GATS, the commitments made by the European Community shall not include:

- National maritime cabotage, and
- Air services, including domestic and international air transportation services whether scheduled, or non-scheduled, and services directly related to the exercise of traffic rights, other than:
    i. Aircraft repair and maintenance services during which an aircraft is withdrawn from service,
    ii. Selling and marketing of air transport services,
    iii. Computer reservation system (CRS) services, and
    iv. Other ancillary services that facilitate the operations of air carriers.

Audio-visual and other cultural services will be treated in a specific audio-visual and cultural co-operation framework. In developing this co-operation framework, the parties will maintain the possibility to preserve and develop their capacity to define and implement their cultural and audio-visual policies for the purpose of preserving their cultural diversity, while promoting cultural and audio-visual exchanges and favouring inter-cultural dialogue.

21. Respecting the respective competences of the EC and its Member States, the parties shall agree to establish a framework for establishment, which will be based on principles of transparency, non-discrimination, market access, stability and on general principles of protection.

    Within this framework, the parties shall agree to grant treatment no less favourable for the establishment in their territory of the companies, subsidiaries or branches of the other party than that accorded to their own companies, subsidiaries or branches, taking due account of the sensitive nature of certain specific sectors.

22. The negotiations should address market access and national treatment across economic sectors and modes of supply and identify areas in which regulatory disciplines have a greater potential to facilitate mutual trade.

23. Whenever an ASEAN partner has concluded another economic integration agreement with a third country which is not within the ASEAN region, EU investors and service suppliers shall be granted at least panty with the treatments granted to investors and service suppliers of this third country as regards to cross-border supply of services and establishment.

24. The Agreement will not preclude the enforcement of exceptions on the supply of services justifiable under the relevant WTO rules (Articles XIV and XIV bis GATS).

TITLE 4: PUBLIC PROCUREMENT

25. The Agreement shall provide for a set of binding rules including adequate transparency provisions that support the setting up of effective procurement systems. They will also provide for challenge procedures and co-operation in the field of electronic procurement. To the extent appropriate, the procurement chapter should be consistent with the revised Government Procurement Agreement.

The Agreement will envisage the progressive liberalisation of procurement markets at national, regional and, where appropriate, local levels, as well as in the field of public utilities, in particular in priority sectors. The objective is to achieve gradual market access on the basis of the principles of non-discrimination and national treatment. Market access commitments will take into account the different levels of development of ASEAN countries.

TITLE 5: TRADE AND COMPETITION

26. The Agreement shall include provisions on competition addressing competition rules and their enforcement.

27. These provisions shall identify. anti-competitive behaviour that would be considered incompatible with the proper functioning of the Agreement, to the extent that it affects trade between the parties, and include rules on restrictive agreements and concerted practices between undertakings, abuse of dominant position, mergers and state aid.

28. The provisions on competition shall address the appropriate legal framework and bodies in charge of implementation of competition rules to guarantee a transparent and an effective enforcement of their respective competition rules.

29. In order to facilitate reciprocal consultations and exchange of non-confidential information between the parties, provisions on appropriate co-operation in the field of trade and competition could be considered on a regional basis.

TITLE 6: INTELLECTUAL, INDUSTRIAL AND COMMERCIAL PROPERTY

30. The Agreement will include rules to ensure effective and adequate protection and enforcement of intellectual property rights (IPR). The Agreement shall include commitments to adhere to multilateral agreements in this field, and well developed elements on the recognition, protection and enforcement of rights, including on geographical indications.

TITLE 7: CAPITAL MOVEMENT AND PAYMENTS

31. The Agreement will strive for full liberalisation of current payments and capital movement, and include a standstill clause. It will entail carve-out provisions (e.g., in case of serious difficulties for monetary and exchange rate policy, or for prudential supervision or taxation), which will be in accordance with the provisions of the EC Treaty on the free movement of capital. Negotiations shall take into account the sensitivities attached to the liberalisation of capital movements not linked to direct investment.

TITLE 8: CUSTOMS AND TRADE FACILITATION

32. The Agreement shall include provisions to facilitate trade between the parties, while ensuring effective controls. To this end, it shall include commitments on rules, requirements, formalities and procedures of the parties related to imports, export and transit.

33. The Agreement shall promote the effective implementation and application of international rules and standards in the field of customs and other trade-related procedures, including WTO provisions, and World Customs Organisation instruments, inter alia, the revised Kyoto Convention. It shall also promote effective regional transit arrangements.

The Agreement shall include provisions to promote the exchange of best practice and experience, relating to particular areas of mutual interest. These areas may include issues such as modernisation and simplification of rules and procedures, standardised documentation, tariff classification, transparency and consultation, and inter-agency co-operation. The Agreement shall promote convergence in the trade facilitation field, where appropriate, building on relevant international standards and instruments.

34. The Agreement shall promote effective and efficient IPR enforcement by customs authorities, regarding imports, exports, re-exports, transhipments and other customs procedures, and in particular as regards counterfeit goods.

35. The parties shall aim at negotiating Customs Co-operation and Mutual Administrative Assistance Agreements which shall include, among others, provisions on joint co-operation, mutual exchange of information, technical expertise, confidentiality and the submission of evidence in judicial proceedings. The parties shall be encouraged to speed up the conclusion of such agreements under the existing mandate of the Commission. The parties should draw upon existing co-operation mechanisms and—may consider developing additional provisions concerning cooperation on trade-related customs issues.

TITLE 9: TRADE AND SUSTAINABLE DEVELOPMENT

36. The Agreement will include commitments by both sides in terms of the social and environmental aspects of trade and sustainable development. The Agreement will include provisions to promote adherence to and effective implementation of internationally agreed standards in the social and environmental domain as a necessary condition for sustainable development. The Agreement will also include mechanisms to support the promotion of decent work through effective domestic implementation of International Labour Organisation (ILO) core labour standards, as defined in the 1998 ILO Declaration of Fundamental Principles and Rights at Work as well as enhancing co-operation on trade-related aspects of sustainable development. Consideration will also be given to measures to facilitate and promote trade in environmental goods, services and technology. The Agreement will foresee the monitoring of the implementation of these commitments, and of the social and environmental impacts of the Agreement, through inter alia review and public scrutiny, as well as instruments of encouragement and trade-related co-operation activities, including with relevant international fora.

TITLE 10: TRANSPARENCY OF REGULATIONS

37. The Agreement will include provisions regarding:

- The commitment to consult stakeholders in advance of the introduction of regulations with an impact on trade;

- The publication of, and public consultations on, all general rules with an impact on international trade in goods and services;

- The procedures to avoid trade problems arising from regulations at an early stage;

- Transparency as regards the administration, implementation and application of regulations having an impact on international trade in goods or services, including appropriate review procedures;

- The creation of enquiry points and one-stop shops designed to provide specific information and to respond promptly to questions and enquiries regarding the operation of the Agreement.

- Commitment to recognise and take steps to implement the principles of good governance in financial and tax areas relating to trade, where appropriate, such as transparency and exchange of information.

TITLE 11: INSTITUTIONAL FRAMEWORK AND FINAL PROVISIONS

38. The Agreement will set up a specific Trade Commission to monitor the implementation of the Agreement. Committees in specific areas may be established as appropriate and will operate under the framework of the Trade Commission.

39. In case of parallel FTA and Partnership and Co-operation Agreements (PCA5) with ASEAN countries, the conclusion of the Free Trade Agreement will be subject to the conclusion of PCAs with the respective countries. The relationship between the free trade and the partnership and co-operation provisions (in one single or two separate agreements) will be decided during the negotiations. This decision will ensure external political and economic coherence in particular in respect of the existence, application, suspension, and termination of the respective provisions. As regards the institutional framework, it will be ensured that the trade and non-trade provisions will be administered through a coherent institutional structure. The Trade Commission shall report to the Joint Committees to be established under the PCAs, according to their bilateral competences.

Dispute settlement

40. The Agreement will include an appropriate and well-functioning dispute settlement mechanism, which will ensure that the parties observe mutually agreed rules.

41. The Agreement will include provisions for expedient problem-solving such as a flexible mediation mechanism. This mechanism would be without prejudice to the parties' rights and obligations or to dispute settlement provided for under the Agreement.

Appendix 3 – Closure

We used a short run closure for the first scenario and a long run closure for the second scenario.

Labour migration

Within each region, labour is completely mobile between sectors. A wage differential is needed to induce labour movement between regions; in percentage change form:

$$xlab\_io(d) = \alpha * averealwage(d) + \lambda,$$

where xlab_io(d) is total employment in region d, and λ is a slack variable determined by fixed national employment—within region wage relativities were constant.[164] We experimented with α values[165] and chose 1 for the simulations reported below. Hence, a 1 percent boost in real wages (relative to other regions) is needed to increase the regional labour force by 1 percent.

The national labour supply and population were fixed. In the long run closure, rates of return are exogenous and capital for each regional industry is in elastic supply, whereas in the short run closure, capital is fixed and rates of return are flexible. Foreign currency prices of imports are obviously exogenous. Other exogenous variables include rates of production tax, technological coefficients, and price and quantity shift variables.

Provincial income

We cannot assume that income earned by newly arrived capital accrues only to local residents. Hence, provincial GDP is not an appropriate indicator of provincial welfare, nor should it be the sole driver of provincial household consumption. Within the confines of a comparative static model, a complete solution of this problem is difficult—and would in any case require data telling how much of each province's capital was owned by foreigners or by Indonesians from other provinces. Such data is unavailable. We implement a cruder, makeshift approach to the problem—by assuming that income of all newly arrived capital accrues to foreigners, while income from pre-existing capital accrues to local residents.

In each province, nominal household consumption moves with modified nominal income.[166] In ordinary change form, we can compute total factor income as follows:

$$delFacInc= 0.01[LND*wlnd + CAP*wcap + LAB*wlab],$$

where delFacInc is the ordinary change in factor income, and LND, CAP and LAB represent values of land, capital and labour. Then, wlnd, wcap and wlab represent percentage changes in land, capital and labour income. Our measure of *modified income*, MI, is:

164 We could also have added an occupational dimension to the equation <ETH> holding constant national supply of labour of each skill category.

165 Certain results are quite sensitive to the values chosen. We did not find any empirical study of Indonesian migration that allowed proper estimation.

166 Modified income consists of labour and land income plus income from original capital. We assume that income from newly arrived capital accrues to foreigners.

$$MI = LND + CAP^{o} + LAB,$$

where CAP^{o} is the initial capital income. Since we assume that land is fixed and income from newly arrived capital accrues to foreigners, we can compute the change in MI as follows:

$$delMI = 0.01[LND*plnd+CAP^{o}*pcap+LAB*wlab],$$

where plnd and pcap are percentage changes of rental on land and capital. We used the original value of capital to tackle the welfare measurement problem. Hence, when we assume that household consumption moves with modified income, this measurement becomes a more sensible welfare measurement ('no free lunch'). Since most Indonesians do not pay income tax, we have excluded income tax from the modified income.

Even though revenue from capital inflows does not accrue to local residents directly, increased capital will tend to raise capital:labour ratios and so increase wages relative to other prices. Since wages do accrue to local residents, capital inflows benefit locals through higher wages.

Other closure details

Real aggregate investment follows provincial demands for capital. Real government consumption is exogenous. Export demand elasticity and export prices determine export volumes. The exchange rate is fixed as a numeraire. Most national results are no more than the sum of the corresponding provincial results. However a few constraints—such as employment—were imposed at the national, rather than the provincial, level.

Appendix 4 – Calculation of Capital Inflow Shocks

Table A1: The share of FDI from the EU in relation to total investment in Indonesia

	Share of EU to total FDI in Indonesia (%)	Share of FDI to total direct investment (%)	Share of direct investment from EU to total direct investment (%)	A 10 percent growth share of FDI from EU in total investment (%)*
	(1)	(2)	(3) = (1)*(2)	(4) = (3)*10%
Food crops and plantation	18	56	10	1.0
Livestock	22	72	16	1.6
Forestry	23	48	11	1.1
Fisheries	16	92	15	1.5
Mining	21	65	13	1.3
Food	21	57	12	1.2
TCF	19	73	14	1.4
Wood	21	58	12	1.2
Paper	16	50	8	0.8
Chemicals	23	76	18	1.8
Petrol refineries	21	75	16	1.6
LNG	21	75	16	1.6
Metals, machinery and electronics	20	86	18	1.8
Other manufactures	21	97	20	2.0
Utilities	19	88	17	1.7
Construction	22	73	16	1.6
Trade	20	93	19	1.9
Hotels and restaurants	21	88	18	1.8
Transport and communications	22	93	20	2.0
Finance	21	75	16	1.6
Government and defence	21	75	16	1.6
Education	21	75	16	1.6
Other services	21	72	15	1.5
All sectors combined	21	75	16	1.6

Note that we use a 10 percent growth share of FDI from the EU to total investment in Indonesia (column 3) to simulate the scenario of capital inflows from the EU to Indonesia. For investment by industry that is not recorded by the BKPM, we apply share of the total investment figure, 1.6 percent (the average share). Column 4 contains the shock by industry applied in the first scenario: EU capital inflows to Indonesia grow by 10 percent.

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