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Analysis

ASEAN's newer members coming to grips with multilateralism

Jayant Menon

When discussing Laos' upcoming ASEAN membership with a senior government official in 1995, he insisted the reason his country wanted to join the regional organisation was because Vietnam had just done so. The response revealed two things. First, Laos, like its neighbouring ASEAN aspirants at the time — Cambodia and Myanmar — did not want to be left behind, and wanted out of the economic wilderness by joining 'the club'. Second, there was very little appreciation of what membership would entail, let alone what it could evolve into.

Arguably the greatest trade policy challenge still facing ASEAN's newer members — Cambodia, Laos, Myanmar and Vietnam (or CLMV) — is the plethora of non-tariff barriers restricting trade. For instance, the red tape associated with importing and exporting is probably a bigger disincentive than any tariff currently in place. Nevertheless, traditional trade instruments such as the tariff and policy relating to its management remain important and should not be ignored. The first challenge on this front was to implement the Common Effective Preferential Tariff (CEPT) scheme of the ASEAN Free Trade Area (AFTA). The new members kept to the timetable and reduced tariffs according to prescribed schedules for imports from other ASEAN member countries — but did little more. In this sense, they missed an opportunity grasped by the original ASEAN members: the new members

did not choose to multilateralise the CEPT preferences, or offer lower tariffs to non-members in a non-discriminatory fashion. Singapore, Malaysia and Brunei Darussalam, for example, had fully multilateralised more than 80 per cent of tariff lines by 2002. For the remaining tariff lines, the margin of preference (MOP) was less than 10 per cent. Today, with the exception of a few sensitive, but admittedly heavily traded, items, all other tariff lines have MOPs of zero or close to it.

Because the preferential tariff reduction schedules have been ambitious and rapid, AFTA has accelerated the pace of multilateral trade liberalisation in the original ASEAN member countries. Instead of jeopardising multilateralism, it has hastened the speed at which these countries have moved toward their goal of free and open trade. In this way, AFTA's greatest achievement may have less to do with what it prescribes or mandates and more to do with what it promotes indirectly through the long-standing commitment of these original members to the concept of open regionalism.

The opposite is true in the CLMV countries. CEPT rates have continued to fall in line with AFTA commitments, resulting in an increase in the countries' respective MOPs since 2005. The [MOP in 2007](#) was almost 15 per cent in Vietnam, and around 7–8 per cent in Cambodia and Laos. Thus, ASEAN's newer members have chosen to operate a two-tier tariff system, with a different CEPT and most favoured nation (MFN) rate for each tariff line. Regionalism through ASEAN

Paper of the Month

The most downloaded paper for the month of October 2011 was [Does governance matter for enhancing trade? Empirical evidence from Asia](#) by Prabir De.

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membership should have provided the CLMV economies with an opportunity to pursue multilateralism aggressively, thus allowing regionalism through AFTA to be a building block, rather than stumbling block, toward free and open trade. But these economies have so far failed to capitalise on the opportunity.

There are numerous other reasons why the CLMV countries should emulate their predecessors. It is almost certain, for example, the CLMV countries could not have anticipated the multitude of ASEAN+1 FTAs they would be dragged into after joining ASEAN. Unless the multilateralisation approach is employed, this is a disaster in the making. It is simply fantastic to expect these countries to effectively implement a system whereby six or more tariff rates can apply to each tariff line, depending on rules of origin that can also differ by source. This is underlined by the fact that the completion dates for the CLMVs vary across FTAs. In this environment of confusing but proliferating ASEAN+1 FTAs, advocacy of the multilateralisation approach has shifted from one which relies on the merits of avoiding trade diversion to one focused on necessity and practicality, recognising domestic administrative and bureaucratic-capacity constraints. These countries would be best-off consolidating all of these preferential and MFN rates around the prevailing lowest rate, which is likely the CEPT rate.

But these countries have a choice, and unlike their predecessors, they have chosen against the multilateralisation approach. The question is, why? One reason could relate to concerns over potential loss in government revenue. Unlike the original ASEAN members, the CLMV countries continue to derive a significant share of government revenue from trade taxes. Retaining a multiple-rate tariff regime is being pursued in an attempt to offset, or mitigate, the anticipated revenue losses associated with AFTA and other FTAs. But is this expectation valid?

What are the likely revenue impacts of the multiple-rate system compared with the one-rate system?

If the multiple-rate system is going to be effective in practice, and offset revenue loss, then customs authorities will have to implement rules of origin to determine what rate should apply to each import. Doing this accurately is very difficult for any country, given globalisation and the fragmentation of production, but it will be close to impossible for the new ASEAN members, given limited capacity and resources. Additional tariff revenue will only be collected if FTA members are levied the higher preferential rate, when they exist, or if non-member country imports are levied the higher MFN rate. But if there is a significant difference between the two rates there will be a strong incentive for trade deflection. Additionally, creating a system whereby multiple tariff rates can apply to each tariff line increases the potential for rent-seeking behaviour, and a higher MFN rate compared with the many preferential rates would provide new opportunities for corruption.

In sum, the multiple-rate system is a second-rate system compared with the multilateralised single-rate system because it is more costly to administer, economically distortionary and therefore welfare-reducing, and unlikely to significantly affect government tariff-revenue collections. It would almost certainly lead to increased rent-seeking behaviour as well. The CLMV countries should follow the original ASEAN members and multilateralise their CEPT tariff preferences and the sooner the better. Looking into the future, both old and new members should also be doing the same with the ever-increasing number of ASEAN+1 agreements.

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