

Michela Astuto<sup>(\*)</sup>

## EU-ASEAN Free trade agreement- negotiations<sup>(\*)</sup>

The EU is one of ASEAN's major trading partners and one of the main sources of investment flows into Southeast Asian countries. In 2009, the European Union was ASEAN's second largest trading partner (after China) and trade with the EU accounted for 11.2% of ASEAN trade. At the same time, ASEAN was EU's fifth largest trading partner, with merchandise trade totaling 118 billion Euro. The EU is the largest foreign investor in the region; during the period 2006 to 2008, European companies have invested on average 10.4 billion Euro per year<sup>1</sup>.

The EU had been considering the opportunity of proposing an FTA to ASEAN countries since 2002. In fact, at the beginning of last decade, ASEAN countries started to build a web of bilateral and regional trade agreements. The conclusion of the first of these agreements, the New-Age Economic Partnership Agreement signed in January 2002 by Japan and Singapore marked a watershed in global trade strategy. It was Japan's first bilateral economic partnership agreement and signaled the beginning of a renewed push for trade agreements.

The main cause of the new trade initiatives lied in the difficulties that WTO-level negotiations were facing at the time. Since the WTO multilateral talks were slowing down, if not stalling altogether, bilateral or inter-regional FTA negotiations were considered to be complementary to or indeed substitutes for multilateral WTO trade talks.

The strategy of the EU was to find partners prepared to participate in FTAs that would not only reduce traditional tariff barriers, but would also cover trade in services, non-tariff barriers, public procurement, and intellectual property rights protection (IPR). The EU Commission wished to bring to the negotiating table also issues such as convergence on regulatory regimes and non-trade issues.

### The Negotiations-A Short history

In 2005, the Vision Group on ASEAN-EU Economic Partnership was established. Its mission was to examine the feasibility of an ASEAN-EU Free Trade Area<sup>2</sup>.

The Vision Group recommended the start of the negotiations for an FTA with a few caveats. In particular, group's report recommended the

<sup>1</sup> Source: European Commission. Directorate-General Trade.

<sup>2</sup> The Vision Group on ASEAN-EU Economic Partnership was established by the ASEAN Economic Ministers and the EU Trade Commissioner at the 6<sup>th</sup> Consultation on 27 April 2005, at Halong Bay, Vietnam.

No. 26 – OTTOBRE 2010

## Abstract

The European Union (EU) became an ASEAN Dialogue Partner in 1980 and relations have since expanded to cover a wide range of areas, from security to economic and trade cooperation.

The EU is one of ASEAN's major trading partners and a main source of investment flows into Southeast Asian countries.

In 2007, a Joint Committee (JC) comprising senior officials was established to work on the procedures, work programme and time-frame for free trade agreement (FTA) negotiations. An inter-regional FTA was perceived to be beneficial to both sides and to ASEAN in particular. It was hoped that a FTA with the EU would further secure and consolidate trade and investment relations with EU countries.

After seven rounds of FTA negotiations, however, in March 2009 the JC agreed on behalf of the EU and ASEAN to take a break «to allow for reflection on the appropriate format for the FTA negotiations».

*Michela Astuto holds a PhD in Southeast Asian Studies (National University of Singapore) and is currently writing on East Asian countries' role in multilateral trade negotiations.*

(\*) The opinions expressed herein are strictly personal and do not necessarily reflect the position of ISPI.

granting of some kind of Special and Differential Treatment for the least developed members of ASEAN (Cambodia, Laos and Myanmar).

The group had also commissioned a quantitative study to assess the economic impact of the envisaged FTA<sup>3</sup>. The study confirmed that traditional tariffs did not represent a significant barrier to trade in manufactured goods between ASEAN and the EU.

Non-tariff barriers (NTBs), however, constituted a serious obstacle to trade on both sides. ASEAN countries considered the greatest impediment to their exports the rigid safety, health, and environmental requirements imposed by the EU regulators. These standards and requirements were often very difficult to meet for developing countries. In addition, the EU imposed tariff quotas on some of ASEAN's agricultural exports. On the other hand, the European countries found that access to ASEAN's service sectors was severely restricted and that inner-ASEAN restrictions hindered the development of trade in services.

The EU's position was that negotiations should cover trade in goods, liberalization of the service sectors as well as investments, rules on NTBs (technical barriers to trade, and sanitary and phytosanitary measures), intellectual property rights protection, and rules of origin. ASEAN countries sought to secure market access in one of their largest markets and to enhance their competitiveness as Foreign Direct Investment (FDI) destination of choice for European companies.

In 2006, the EU Commission announced the new trade strategy for the Union: in *Global Europe: Competing in the World* defined the guidelines for the new market-opening commercial strategy that the EU would follow in its negotiations, both at the multilateral and bilateral level<sup>4</sup>.

The EU Commission confirmed its commitment to a multilateral trading system. However, it also made clear that FTAs would be pursued in order to promote market openness and integration, and to deal with issues such as investment, public procurement, regulatory issues and IPR enforcement.

The EU's 2006 paper also stated the criteria for the choice of FTA partners. The main criteria were market potential (economic size and growth), the level of protection against EU exporters (tariff and non-tariff barriers), and the potential partners' negotiations with EU competitors. Based on these criteria, ASEAN, Korea, and Mercosur were identified as preferred partners.

In 2007, a joint committee (JC) comprising senior officials was established to work on the modalities, work programme and timeframe for the FTA negotiations. The ASEAN-EU JC met seven times to develop the details of the negotiations and six Expert Groups were set up – Trade in Services /Investment, Rules of Origin, Sanitary and Phytosanitary (SPS) measures, Technical Barriers to Trade (TBT), Customs and Trade Facilitation, and Dispute Settlement. However, in March 2009, at the 7<sup>th</sup> Meeting of the Joint Committee, the parties agreed to temporarily interrupt negotiations «to allow for reflection on the appropriate format for the FTA negotiations».

### Issues of Negotiations

The complexity and the wide range of issues up for negotiations were clearly the major causes of the need for a pause for reflection. Another important reason for the stalling of the region-to region negotiations was the configuration issue. The EU Commission received the mandate to negotiate with seven of the ASEAN countries; the mandate left out the three Least Developed Countries of ASEAN, although it left the door open to Cambodia and Laos to join the agreement in the future. The EU decided not to negotiate with Burma. Since the beginning there were doubts about the choice of negotiating one regional agreement instead of seven bilateral deals and the negotiations were probably affected by those doubts.

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<sup>3</sup> CEPII (Centre d' Etudes Prospective et d'Informations Internationales), *Economic Impact of a Potential Free Trade Agreement (FTA) Between the European Union and ASEAN*, 3 May 2006.

<sup>4</sup> Commission of the European Communities, *Global Europe: Competing in the World. (A Contribution to the EU's Growth and Jobs Strategy)*, Communication, Brussels 4.10.2006.

### 1) *Tariff and Non-Tariff Barriers*

As mentioned above, the possible gains from tariff reduction would be modest, because most ASEAN countries apply low tariffs on EU imports, and those of the EU on imports from ASEAN countries are low as well. Tariff peaks remain on some agricultural products and the transport equipment sector.

The share of agriculture in EU-ASEAN merchandise trade was less than 7% in 2009. The EU was ASEAN's second largest market for agricultural exports, while the EU was ASEAN's third largest source of imports. The EU's agricultural trade balance with ASEAN has historically been negative. The Union applies tariffs quotas on some ASEAN's exports, e.g. cassava.

The EU's stance on agricultural trade has consistently been defensive, trying to limit any negative consequences for domestic producers. That did not change during the negotiations with ASEAN. It has even been advised by informed observers to replicate the choice of Japan in its FTA with Singapore and exclude agriculture from the negotiations<sup>5</sup>.

A reduction of tariffs on manufactured goods could, however, have a positive impact on trade between the two regions because a large share of imports is intra-firm trade, since many European companies have established production platforms in ASEAN countries.

Greater benefits could be expected from the reduction of non-tariff barriers. Negotiations on NTBs are complex and typically sensitive because they directly concern domestic regulations. They are often put in place as tools for protecting domestic producers. Technical barriers to trade may arise when producers have to modify their products to comply with importing country's requirements – requirements imposed because of health, safety, or environmental protection). The costs of compliance can be substantial.

The outcome of the Uruguay round negotiations on technical barriers to trade, including sanitary and phytosanitary measures, consisted of a set of general guidelines that should govern the behavior of the WTO members in the areas concerned. These guidelines are based on the two principles of harmonization and equivalence. When national standards are based on those agreed upon by international institutions, domestic rules are presumed to be consistent with GATT disciplines: in these cases, the so-called 'principle of harmonization' is applied. When harmonization at the international level has not been achieved, or it is not regarded as necessary, the principle of equivalence is used: importing countries accept that exporting countries' technical standards are comparable (but not necessarily identical) with their standards, insofar as they provide the required levels of sanitary and phytosanitary protection.

The country objecting to the application of the principle of equivalence must provide scientific evidence to substantiate its claims.

The implementation of such an agreement undoubtedly depends on how governments interpret its guiding principles.

The EU has signed a few bilateral mutual recognition agreements (MRA), in line with the WTO agreements on Technical Barriers to Trade.<sup>6</sup> These agreements are all sectoral, and have being signed with the US, New Zealand, Australia, and Japan.<sup>7</sup> It is very unlikely that similar agreements could be signed with any of the ASEAN countries, with the possible exception of Singapore.

The EU Commission proposed to forbid any ban, restrictions or other non-tariff<sup>8</sup> barriers that could not be justified by the general exceptions of GATT Art. XXI.<sup>9</sup> It also suggested discussing both product specific and sector specific NTBs, and to agree on preventive measures – based on consultation – to avoid new NTBs.

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<sup>5</sup> W. VAN DER GEEST, *AN EU-ASEAN Free Trade Agreement: Sharing the Benefits of Globalization?*, Lecture delivered at the 9<sup>th</sup> ASEF University Session, Manila, 6 February, 2004.

<sup>6</sup> An MRA allows that products from the partner country can be assessed for conformity with EU regulations in the testing facilities of that country. Similarly, EU exports can be tested for conformity with the partner countries regulations in EU accredited testing establishments. See W. VAN DER GEEST, cit., p. 14.

<sup>7</sup> See, for instance *EU-US Mutual Recognition Agreements*, in B.M. HOECKMAN - M.M. KOSTECKI, *The Political Economy of the World Trading System*, Oxford and New York 2001, p. 191.

<sup>8</sup> W. VAN DER GEEST, cit., p. 15.

In tackling non-tariff barriers, the EU Commission requested to include restrictions on access to resources. In particular, the EU Commission was asking for the elimination of all export taxes on some products, e.g. natural rubber. Many ASEAN countries still impose export taxes on primary raw materials and have been most unwilling to eliminate them during the WTO rounds.

## 2) Services, and Investment rules

The EU Commission repeatedly expressed its willingness to negotiate a significant liberalization of trade in services between the two regions. The Union lamented that «by allowing commitments to eliminate only those trade barriers that members are ready to abolish, the General Agreement on Trade in Services (GATS) allows member states to set their individual pace for trade liberalization in services»<sup>10</sup>.

The EU had prepared a negotiating framework for 'services, establishment and e-commerce'; it was using this template in its negotiations with Mercosur and intended to apply it to its new FTAs too. The EU trade balance in services with ASEAN reported a deficit, and the EU Commission believed that this situation was caused by «non-tariff barriers and markets tilted against foreign service providers. ... The same it [was] true for Foreign Direct Investment in general»<sup>11</sup>.

The EU proposed a GATS-consistent sectoral approach with a special attention to market access and national treatment. It is noteworthy that EU member states did not want to hand over to the EU Commission their competence to negotiate Bilateral Investment Treaties (BITs) or to change the contents of those already in force<sup>12</sup>.

Still, BITs deal only with the treatment that foreign investors will get "post-entry" or "post-admission" meaning that they do not provide for specific commitments on the conditions of entry for investors. The EU Commission sought to negotiate agreements that would fill the gap and cover pre-establishment rights for European companies.

The EU sought also to ensure full parity with those of its competitors that had signed – or were in the process of signing – FTAs with ASEAN.

The main motivation for the Southeast Asian nations to engage in negotiations on services and investment rules with the EU was naturally to increase their attractiveness as destinations for foreign direct investments.

## 3) IPR, Public Procurement, and Competition

As regards IPR, the EU Commission noted that the biggest challenge facing EU producers was the enforcement of existing commitments: therefore, the Union would not press for new commitments, but demand that its ASEAN partners sign existing IPR agreements (for example, the Paris Convention, and the Patent Cooperation Treaty). The EU also wanted to obtain recognition for its geographical indications and appellation of origin.

The EU Commission identified in public procurement an area of untapped potential for EU exporters. European companies are extremely competitive in sectors such as public works or utilities. However, according to the EU, «discriminatory practices ... effectively close off exporting opportunities»<sup>13</sup>. Amongst ASEAN countries only Singapore acceded to the WTO Agreement on Government Procurement in 1997. Negotiations on this issue are very challenging because public procurement has been routinely used in many ASEAN countries as industrial policy tool to facilitate the development of the domestic firms.

<sup>9</sup> Article XXI of GATT allows measures to be imposed whenever a government considers this «necessary for protection of its essential security interests» both «in times of war» or «other emergency in international relations».

<sup>10</sup> European Parliament, *Report on Regional Free Trade Areas and Trade Strategy in the European Union. Explanatory Statement*, 3 April 2003.

<sup>11</sup> P. MANDELSON, *EU Trade Commissioner. Remarks on the Ford Report on ASEAN FTA*, Brussels 7 May 2008.

<sup>12</sup> With a total of almost 1200 agreements that cover all forms of investment, [EU] Member States together account today for almost half of investment agreements currently in force around the world. Ireland is the only EU Member State that does not maintain any BIT with a third country. European Commission, *Towards a Comprehensive European Investment Policy*, Communication, Brussels 7.7.2010.

<sup>13</sup> *New Areas of Growth*, in *Global Europe: Competing in the World*, cit., 2006.

According to the EU Commission, the FTA with ASEAN should have also included strong trade facilitation provisions. In this context, the EU asked ASEAN governments to adopt a competition policy based on the principles of transparency, non-discrimination, and procedural fairness along the lines of the EU legislation. When the FTA negotiations started, most ASEAN countries did not have a competition law. Statutory boards were in charge of the competition policy and had regulatory and monitoring responsibilities.

EU requests for more transparent rules had an additional objective: state aid and other subsidies. ASEAN states had traditionally conducted a very active industrial policy and the EU believed that there had been many cases of 'unfair subsidization' and proposed to bring this issue at the negotiating table.

The mandate of the EU Commission contained many references to sustainable development, in particular to labor and environmental standards. These are extremely contentious issues which ASEAN countries were not willing to discuss.

#### **4) Special and Differential Treatment**

Even though the three least developed nations of ASEAN had not been included in the FTA negotiations, most Southeast Asian countries are still officially developing economies, and therefore enjoy according to WTO rules so-called "Special and Differential Treatment Privileges". The above mentioned Vision Group recommended that «the disparity between ASEAN and the EU as well as among members of ASEAN should be taken ... into account» during the negotiations.

Neither the Vision Group Report nor or any other official document on the creation of a FTA between ASEAN and the EU mentions the so-called concept of "asymmetry".

Asymmetry is one of the fundamental concepts of the negotiations on Economic Partnership Agreements between the EU and the ACP countries. Introducing the principle of asymmetry would have meant that the EU would have had to remove 95% of its tariffs, allowing in turn its developing partner countries to eliminate tariffs only of 85%<sup>14</sup>.

"Special & Differential Treatment" was also ignored in relation to rules of origin. It appeared clear that the EU was willing to discuss about S&D only in the form of longer implementation periods for developing countries. The EU naturally conflicted with the preferences of the developing countries of ASEAN that were worried to see, for instance, their GSP preferences disappear without getting in return adequate credit for this loss<sup>15</sup>.

#### **The Configuration Puzzle**

When the EU started considering the opportunity to create new trading arrangements with Asian partners, the most promising course appeared to be what were called 'path-finding' bilateral FTAs<sup>16</sup>. The EU was aware that negotiating an agreement with a region and a block of countries was more complicated and time-consuming than an agreement with a single nation<sup>17</sup>. Nonetheless inter-regional agreements might offer significant benefits to all participants, including the reduction of the variety of regulations with which companies have to comply.

Starting in 2002, ASEAN successfully negotiated and signed several preferential trade agreements with some of its most important trading partners – China (2002), Japan (2008), India (2009), South Korea (2009), and Australia and New Zealand (CER) (2009). At the same time, individual ASEAN countries signed numerous bilateral trade agreements. There was a concern that, if not properly designed and managed,

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<sup>14</sup> The percentage of goods or services to be covered in the FTAs is conventionally set at 90%.

<sup>15</sup> On European Union and S&D in FTAs, see also M. MAES, *The EU Approach to FTA Talks in ASEAN, India, Korea*, Published in SUNS#6171, 18 January 2007.

<sup>16</sup> European Parliament, *Report on Regional Free Trade Areas and Trade Strategy in the European Union. Explanatory Statement*, 3 April 2003.

<sup>17</sup> European Parliament, *Report On Trade and Economic Relations with the Association of Southeast Asian Nations*, Committee on International Trade. Rapporteur: Glyn Ford. 14.04.2008. Explanatory Statement.

these overlapping FTAs could end up becoming a stumbling block towards integration efforts<sup>18</sup>. A region-to-region arrangement could contribute to alleviate those concerns.

Nevertheless, problems became evident since 2008. The European Parliament noted that reports of the negotiating rounds did not leave great hopes for an early and comprehensive conclusion. The reports highlighted instead «difficulties (on the ASEAN side) in developing a common position and a lack of political will»<sup>19</sup>.

The negotiations experienced serious problems also because the capabilities of the ASEAN states were stretched by the large number of FTAs they were negotiating<sup>20</sup>.

The solution to what was looking increasingly like an impasse was found in the introduction of some flexibility in the final configuration of the agreement. Instead of a single undertaking, the configuration would be at 'variable geometry' in order to take into consideration the different levels of economic development within ASEAN and to allow to proceed at a faster pace with individual partner countries. This negotiating flexibility would have left the door open for others to join in at their own speed.

Nonetheless, the idea of a more flexible negotiating framework-even if based on a previous FTA negotiated by ASEAN – the ASEAN-Korea FTA of 2006 left out Thailand-did not solve the complexities of the issues at stake.

In March 2009, the parties agreed to a temporary suspension of EU-ASEAN FTA negotiations and the talks remain suspended until the present day.

## Conclusions

By December 2009, the EU Commission received the mandate to negotiate FTAs with individual ASEAN member countries.

Failure to reach a region-to-region agreement can be ascribed to several causes. When the negotiations started the Commission saw that the quickening pace of global economic integration while creating unprecedented opportunities for growth and development, was putting under serious strain traditional European industries and workforce: the rejection of protectionism had to be accompanied by deliberate political and diplomatic action to open markets and create fair conditions for trade abroad.

The EU remained firmly committed to the WTO system; however, the suspension of the Doha negotiations determined a need for trade initiatives that could both open markets and serve as a catalyst for resuming the Round. The EU was then prepared to negotiate new FTAs with potential partners; in particular, the Commission considered that European interests in Asia needed to be taken care of more vigorously.

In fact, Asian countries were aggressively creating an intricate web of trade agreements. The Commission noted that «in the context of multiplication of bilateral and regional free trade initiatives in South East Asia, the EU has both offensive and defensive interests in forging stronger economic ties with the region»<sup>21</sup>. The new European trade strategy for Southeast Asia would then be "offensive", seeking to advance European presence in important and growing markets, and "defensive" aiming at protecting its existing economic interests in Southeast Asia.

The preference for a region-to-region agreement was based on the conviction that FTAs might also complicate trade, and therefore, a single agreement would have been more trade-efficient than seven bilateral deals.

The Commission's goals had therefore, two main components. On the one hand, there was a strategic objective: the defense of European economic (and political) interests in an area of great economic

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<sup>18</sup> See, for instance, R. SEN - S. SRIVASTAVA, *ASEAN's Bilateral Preferential trade and Economic Cooperation Agreements*, in «ASEAN Economic Bulletin», 26, 2, August 2009, pp.194-214.

<sup>19</sup> European Parliament, *Report. On Trade and Economic Relations with the Association of Southeast Asian Nations*, Explanatory Statement, 14.04.2008

<sup>20</sup> P. MANDELSON, *EU Trade Commissioner. Remarks to the Ford Report*, 7.05.2008.

<sup>21</sup> EU Commission. *Communication, A New Partnership with South East Asia*, 2004.

dynamism, where European competitors were active in building alliances and partnerships. On the other hand, there were trade-specific issues, such as market opening initiatives, the inclusion of WTO-plus issues (such as investment and competition rules), and harmonization of regulatory systems.

The complexity and sensitivity of the trade negotiations conflicted with the larger strategic goals; the Commission came to the realization that trade issues could be more easily solved through bilateral negotiations, while strategic regional interests were better served in different settings – such as the ASEAN Regional Forum (ARF) or Asia Europe Meeting (ASEM).

Currently it seems that EU has returned to the suggestion made by the European Parliament in 2003 to choose a partner in Asia with the capacity to address difficult issues, such as non-tariff barriers, investment, competition, and regulatory convergence. A country that could help the EU in achieving an agreement that could serve as credible benchmark for later arrangements: That country is Singapore<sup>22</sup>.

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Le pubblicazioni online dell'ISPI sono realizzate anche grazie al sostegno della Fondazione Cariplo.

ISPI  
Palazzo Clerici  
Via Clerici, 5  
I - 20121 Milano  
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<sup>22</sup> European Parliament, *Report. On Regional Free Trade Areas and Trade Strategy in the European Union*, Explanatory Statement. The EU started talks with Singapore in March 2010.

