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ASEAN Prosperity Initiative

EU-ASEAN FTA Report

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API
ASEAN Prosperity Initiative

The ASEAN Prosperity Initiative

The ASEAN Prosperity Initiative (API) is designed to highlight issues and raise questions over the development of ASEAN and its role in supporting the prosperity of its Member States and their citizens. The API will include the production of reports and material which aim to improve understanding about the main developments and challenges relating to prosperity in ASEAN. The API is intended to engage a broader set of stakeholders in the debate on the future of ASEAN, including business, academia and the general public.

The Institute for Democracy and Economic Affairs (IDEAS) is an independent research institute based in Malaysia. We are dedicated to researching and promoting solutions to public policy challenges. We believe that economic freedom – through free markets, open trade and individual liberty – are essential to sustained prosperity and we believe that ASEAN plays an important role in enhancing and protecting the economic freedom of its citizens. We therefore make no secret about the fact that we strongly support an ambitious agenda of economic integration in ASEAN, and through the API, we we hope to support this agenda.

In this report under the API we consider the economic relationship between ASEAN and the European Union (EU). The comparison is often made between these two regional blocs, which represent the two leading efforts to integrate their respective regions. The EU's economic integration is significantly deeper and supported by a far more developed institutional and legal framework. The EU is in general more economically developed than ASEAN and is also more homogeneous in its level of development across its Member States than is the case across the 10 members of ASEAN. Although both have been widening over the years by accepting new members, this has added more to ASEAN's overall diversity than it has the EU's, further increasing the overall heterogeneity between the two groupings. Despite these differences, we believe that ASEAN and the EU share an essential similarity: they are both groupings of countries that recognise the importance of regional integration and the benefits of trade and investment in the context of a rules-based system. We therefore believe that putting the economic relations between the EU and ASEAN on the best possible footing is crucial to the long-term prosperity of ASEAN, as well as the EU.

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ASEAN and the EU

In this report we consider the economic relationship between the EU and ASEAN and the prospects for strengthening that relationship, through agreement of a region-to-region, EU-ASEAN Free Trade Agreement.

The EU and ASEAN have a long history of co-operation. The relationship started with the EU's predecessor, the European Economic Community (EEC). In 1973, the EEC and ASEAN signed their first co-operation agreement, only six years after the creation of ASEAN. This was the first interregional cooperation agreement ever entered into by Western Europe as a whole with another foreign regional body. This symbolic importance coupled with the tendency of the EU, as part of its soft power approach to international relations generally, to promote regional integration elsewhere gives a unique significance to EU-ASEAN relations (Camroux, 2008).

These early relations were strengthened by the formation of the ASEAN-EC Ministerial Meeting (AEMM) in 1978 after the EC became one of ASEAN's external dialogue partners in 1977 (Yeo, 2017). This led to the signing of the ASEAN-EC Cooperation Agreement which provided an institutional and legal framework for deepening economic ties. Over the following years the EC-ASEAN relationship was best with political difference and remained towards the bottom of the EC's list of priorities (Yeo, 2017).

EU-ASEAN relations were reinvigorated in 2003, when the EU decided to adopt a more pragmatic approach. The European Commission published a strategy titled "A New Partnership with Southeast Asia", which recommended that the EU focus on relations at both bilateral and regional levels. The EU subsequently scaled up efforts to engage ASEAN, particularly in the area of providing support for capacity-building towards integration with programmes such as the ASEAN Programme for Regional Integration Support (APRIS) from 2003-2010 to the current ASEAN Regional Integration Support from the EU (ARISE).

The EU proposed a regional framework called the "Trans-Regional EU ASEAN Trade Initiative" that could be developed into an ASEAN-EU preferential trading agreement. Subsequently, in 2005 the European Commission and ASEAN Economic Ministers constituted the Vision Group with the task of investigating the feasibility of new initiatives on closer economic co-operation, including a potential inter-regional EU-ASEAN FTA. In 2006 the Group presented the final report opening the way to formal FTA negotiations (Lim, 2012). Around the same time, the European Commission produced a new trade strategy, titled "Global Europe – competing in the world", which declared future FTAs would need to be ambitious and comprehensive agreements, liberalizing not only trade in goods, but also regulating trade in services, investments and many trade-related issues such as intellectual property rights (IPR), competition policy and environmental and social aspects of trade (Mazur, 2013).

In April 2007, the European Council endorsed the negotiating directive for a comprehensive free trade agreement between the EU and ASEAN. Unfortunately, the initial optimism quickly dissipated – the EU expressed disappointment with the slow rate of progress in November 2017. According to the EU, the main issues with progressing the negotiation were: lack of negotiating capacity on the part of ASEAN; a difficulty in reaching collective positions across ASEAN Member States; and a lack of political will, particularly to consider the depth of liberalisation expected under the EU's new trade strategy (Mazur, 2017). As a result, negotiations on the region-to-region agreement were paused in 2009 and later that year the European Council endorsed new negotiating mandates for bilateral Free Trade Agreements with individual ASEAN Member States.

Bilateral EU FTAs in ASEAN

Singapore

Following the suspension of negotiations on an EU-ASEAN FTA, the EU immediately commenced negotiations on a bilateral FTA with Singapore (EUSFTA) which concluded with an agreement in October 2014. Given the profile of both parties' economies, the negotiations focussed on achieving far reaching liberalisation of trade in services. As a result, the final FTA included provisions on regulations on trade and services, investments, public procurement, intellectual property rights including geographical indications (GIs), commitments on environmental aspects and sustainable development (European Commission, 2013). These provisions would classify this agreement as a WTO-plus, high-quaulity FTA.

Vietnam

In December 2015, the EU concluded its second FTA with an ASEAN Member, when it agreed the EU-Vietnam FTA (EVFTA). Following a decision to expedite ratification in light of concerns over investment, the Investment provisions were separated from the rest of the FTA. The final text of the agreement alongside the EU-Vietnam Investment Protection Agreement (IPA) were agreed in July 2018. This agreement is considered to be the most comprehensive free trade agreement that the EU has ever concluded with a developing country (Mazur, 2017). The deal liberalises 99% with customs duties removed over a transitional period of 7 years for the EU and 10 years for Vietnam (European Commission, 2016).

Malaysia

Negotiations for an FTA with Malaysia were launched in October 2010, however insufficient progress was made, and the talks were subsequently paused in April 2012. The principal reason cited for insufficient progress was that Malaysia was focussed on securing an arrangement for trade in goods and was not prepared to liberalise in other respects expected by the EU, including procurement, competition policy and Intellectual Property Rights (IPR) (Mazur, 2017). A particular sticking point is the long-standing Malaysian policy of promoting economic development of the ethnic Malay population through policies of equity transfer and targeted procurement that are incompatible with principles of open competition. Addressing these policies has been an issue in other trade negotiations, including the Trans Pacific Partnership (TPP) and its successor the Comprehensive and Progressive Agreement for Trans Pacific Partnership (CPTPP).

Since the negotiations were paused in 2012, the European Parliament agreed a resolution to phase out the use of palm oil, in light of environmental concerns, specifically the role of the palm oil industry in accelerating deforestation (European Parliament, 2017). The European Parliament also called for sustainability criteria to be applied to EU imports of palm oil. These developments have had major implications for the EU's relationship with Malaysia and Indonesia, who are the world's main producers of palm oil. The EU's position on palm oil has been strongly criticised in Malaysia, in particular given the challenges Malaysia's 600,000 small holders face in complying with sustainability criteria (Ching & Majid, 2017).

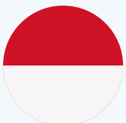
During this same period, Malaysia was also excluded from the EU's General System of Preferences (GSP). This regime exists to offer less developed countries preferential trading terms with the EU. However, Malaysia's economic development means that it no longer qualifies for this preferential statement, putting Malaysia at a disadvantage compared to other ASEAN Member States who either have negotiated FTAs or remain eligible for special preferences.

Negotiations between Malaysia and the EU were relaunched in March 2017, but it remains to the be seen whether the prior issues can be resolved., particularly in light of the ongoing palm oil dispute.

Thailand

Negotiations for an EU-Thailand FTA were launched in March 2013. However, negotiations were suspended following the military coup in Thailand in May 2014. In November 2013, the EU and Thailand negotiated a Partnership and Cooperation Agreement (PCA), which provides a comprehensive framework for EU-Thailand relations and will open up wide opportunities to develop cooperation. However, the EU will not sign this agreement or progress negotiations on an FTA until there is democratically elected government in place in Thailand (European Commission, 2018). There are elections scheduled in February 2019, and the EU has signalled it will progress talks on an FTA rapidly if a democratically elected government is installed (Aujarint, 2018).

Thailand was excluded form the EU GSP on 1 January 2015, one year after Malaysia, putting it at a similarly disadvantageous position when it comes to trading with the EU. This has increased pressure within Thailand to secure an FTA with the EU.



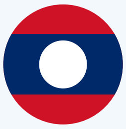
Indonesia

In July 2016, the EU and Indonesia agreed to launch negotiations on a FTA in the form of a Comprehensive Economic Partnership Agreement (CEPA). The political intention is to reach agreement by the end of 2019. Given Indonesia's status as the world largest producer of palm oil, the European Parliament's resolutions on palm oil will continue to be a significant source of disagreement. There are likely to be other issues as well. Indonesia employs a number of anti-competitive procurement policies, including local content requirements, which the EU will seek to liberalise. Indonesia also employs IPR policies which will be problematic for the EU, such as the mandatory licensing of medicines (Setiati and Ferguson, 2018).

Unlike Malaysia and Philippines, Indonesia retains GSP status, which provides some degree of preferential access to EU markets. However, a FTA would be expected to provide much broader access and on an enduring basis.

Philippines

In December 2016, the EU and the Philippines agreed to launch negotiations on a FTA. As with Indonesia, the most problematic issues will be the extent to which the Philippines is prepared to liberal in priority areas for the EU, such as procurement. On the political front, the EU has expressed concern over human rights in the context of President Duterte's "war on drugs" but the talks have not been suspended.



Cambodia, Lao PDR and Myanmar

The EU is not currently negotiating FTAs with Cambodia, Lao PDR or Myanmar. However, each of these countries benefits from the most favourable preferences under the GSP, namely the Everything But Arms (EBA) scheme. The EBA scheme gives the 47 Least Developed Countries – including Cambodia, Lao PDR and Myanmar – duty free access to the EU for exports of all products, except arms and ammunition.

However, in light of concerns over human rights the EU has informed Cambodia that it will be excluded from the EBA scheme in 2019, unless its makes "clear and demonstrable improvements" to its human rights record (Radio Free Asia, 2018). The EU has also announced that Myanmar will be excluded from the EBA scheme unless its record on human rights improved. The EU has stressed that Myanmar "must uphold and respect the principles enshrined in [UN and ILO] conventions" to continue to enjoy duty-free access (European Commission, 2018). This underlines the political challenges which would likely arise in the event the EU sought to negotiate FTAs with either Cambodia or Myanmar.

Table 1: below summaries the progress of trade negotiations between the EU and ASEAN.

Table 1. Summary of EU Trade negotiations with ASEAN and its Member States, 2018

Partner	Proposed Agreement	Date Launched	Date Concluded	Generalised Trading Preference
ASEAN	EU-ASEAN Free Trade Agreement	2007, subsequently suspended. Relaunched in 2017	No agreement reached	Various
Singapore	EU-Singapore Free Trade Agreement	March 2009	October 2014	None
Vietnam	EU-Vietnam Free Trade Agreement	June 2012	October 2015	GSP
Malaysia	EU-Malaysia Free Trade Agreement	October 2010 subsequently suspended. Relaunched in March 2017	Not agreed	None
Thailand	EU-Thailand Free Trade Agreement	March 2013, subsequently suspended.	Not agreed, currently suspended.	None
Indonesia	EU Indonesia Comprehensive Economic Partnership Agreement	July 2016	Not agreed	GSP
Philippines	EU Philippines Free Trade Agreement	December 2016	Not agreed	GSP+
Cambodia	No agreement	N/A	N/A	EBA (under review)
Lao PDR	No agreement	N/A	N/A	EBA
Myanmar	No agreement	N/A	N/A	EBA (under review)

EU-ASEAN FTA relaunched

The EU has consistently stated that it views the bilateral FTAs it has or is negotiating with individual ASEAN Member States as building blocks towards a broader region-to-region FTA (European Commission, 2018). Accordingly, in March 2017, the EU and ASEAN agreed to re-launch negotiations on an EU-ASEAN FTA. However, there are already signs that reaching a deal will be as difficult as before, with reports that ASEAN Member States are "not convinced" of the benefits of deal (Euractiv, 2018). At the time of writing, the talks are officially ongoing, although there are few indications significant progress is being made and the EU is continuing to pursue bilateral arrangements in parallel. These difficulties are not unique to this agreement, as attempts to harmonise accords in achieving a consolidated, broader deal has always been challenging, as evidenced by the prolonged Regional Comprehensive Economic Partnership (RCEP) negotiations, for instance, despite ASEAN having concluded a bilateral FTA with each of its dialogue partners.

Benefits of EU-ASEAN Free Trade Agreement

In the context of renewed efforts to agree a FTA between ASEAN and the EU, it is important to consider the potential benefits that could accrue to both sides, both in terms of trade and other areas.

In economic terms, an FTA would be expected to increase total trade, resulting in faster GDP growth. Export orientated sectors in both the EU and ASEAN would be expected to grow as a result of having access to new markets. Increased trade would also be expected to result in a greater level of competition, which in turn increase productivity through greater pressure to innovate. Higher competition would also result in contraction in some sectors, subject to pressure from more competitive products and services from abroad.

In their macroeconomic assessment of the impact of an EU-ASEAN FTA, the Institute for International and Development Economics (IIDE), concluded that an EU-ASEAN FTA would result in "positive effects for most of ASEAN under all scenarios, and small but positive effects over the long-run for the European Union" (IIDE, 2009). They also note that: "The productivity effects of an EU-ASEAN FTA are also visible in the form of higher wages for both skilled and unskilled workers. This is particularly important for ASEAN as this would mean that the employment increase in key growth sectors will outstrip the reduction of employment in contracting sectors" (IIDE, 2009). Table 2 highlights the expected potential gains from an "extended FTA", IIDE's middle scenario in terms of both short and long run impacts on GDP.

Table 2. highlights the expected potential gains from an "extended FTA", in IIDE's middle scenario in terms of both short and long run impacts on GDP.

Scenario	EU-27	IN	MY	PH	SG	TH	VN	Other ASEAN
Extended FTA (short run)								
GDP % Change	0.05	0.99	1.17	0.60	3.55	0.39	3.46	0.29
Extended FTA (long run)								
GDP % Change	0.20	3.39	6.85	4.12	12.32	4.81	14.02	3.71

Source: IIDE (2009)

This study is from 2009, and these projections will need updated, but the scale of the potential impact is clear. These headline benefits would arise as a result of liberalisation of trade, achieved through reform in a number of different areas, including tariffs, non-tariff measures, investment, procurement and IPR.

Tariffs

The most obvious benefit of an EU-ASEAN FTA would be the elimination of all, or nearly all, tariffs on both sides. Tariffs are taxes on imports or exports between sovereign states and are used as a tool to regulate trade. Since tariffs increase the cost of trade, they inevitably reduce incentives to trade. As a result product markets are subject to a lower level of competition, generally resulting in a lower level of innovation and higher prices for consumers and producers who use imported inputs. Unless an FTA or other preferential agreement is in place, then World Trade Organisation (WTO) Members are obliged to offer each other Most Favoured Nation (MFN) tariff rates on imports of goods.

In the case of the tariffs which currently apply between the EU and ASEAN, there are a number of current and planned trade preferences which result in lower tariffs. As part of the FTAs agreed with Singapore and Vietnam, rates on most tariff lines will be abolished, although this process will take several years. In the case of Indonesia, the Philippines, Cambodia, Lao PDR and Myanmar, the EU's GSP schemes apply which reduce tariff lines for many products. Malaysia and Thailand do not enjoy these benefits and therefore would have the most to gain from the elimination of tariffs through a negotiated FTA. Furthermore, Indonesia and the Philippines will at some point achieve a level of development that excludes them from the GSP, at which point they too would be subject to the EU's MFN rates. In the case of Cambodia and Myanmar the EU has initiated a review of these countries' membership of the EBA scheme which could see them excluded, for non-economic reasons. This underlines the importance of securing permanent preferences through an FTA (although in the case of Cambodia and Myanmar, the same political concerns would also complicate such an agreement).

Tables 3 and 4 detail the tariff costs that would apply in the event that all EU and ASEAN exports were subjected to Most Favoured Nation (MFN) tariff rates, to illustrate the potential gains from securing tariff reductions through an FTA, if GSP preferences did not apply.

Table 3. EU and ASEAN EFN Tariffs applied to ASEAN and EU Agriculture exports, 2017

Agricultural Trade						
Country	**ASEAN exports to EU ($M)**	**EU MFN Tariff Costs ($M)**	**%**	**EU exports to ASEAN ($M)**	**ASEAN MFN Tariff Costs**	**%**
Brunei	0.01	0.00	2%	14.16	-	0%
Cambodia*	179.77	8.47	5%	67.11	10.92	16%
Indonesia*	1,059.97	108.80	10%	737.27	75.00	10%
Lao PDR*	26.33	2.11	8%	6.27	1.42	23%
Malaysia	181.13	19.73	11%	1,132.29	85.93	8%
Myanmar*	116.98	5.02	4%	40.38	5.54	14%
Philippines*	344.47	44.02	13%	1,499.87	228.24	15%
Singapore**	1,112.99	83.97	8%	2,106.97	-	0%
Thailand	1,449.09	147.81	10%	912.92	264.95	29%
Viet Nam**	2,962.12	132.42	4%	802.80	163.85	20%
Total	7,432.85	552.36	7%	7,320.03	835.85	11%

*Source: WTO Tariff data from http://tariffdata.wto.org/, author's calculation based on applying MFN rate at 2-digit HS code, * denotes countries with currently enjoy lower rates due to membership of GSP schemes, **denotes countries that will enjoy lower tariffs due to FTAs with the EU having been agreed*

From the EU's perspective, gains from tariff reductions for agricultural exports could be significant. Although it should be noted that some high rates are in place due to cultural policies, such as high duties on alcohol in Muslim countries, so it is not clear how far these could be reduced. The potential gains for ASEAN's Member States are slightly lower, given that the EU applies generally lower tariff rates and because of the profile of ASEAN exports, but nonetheless represent a substantial share of the volume of trade.

Table 4. EU and ASEAN EFN Tariffs applied to ASEAN and EU Non-Agriculture exports, 2017

Non-Agricultural Trade						
Country	**ASEAN exports to EU ($M)**	**MFN Tariff Costs ($M)**	**%**	**ASEAN imports from EU ($M)**	**MFN Tariff Costs**	**%**
Brunei	12.68	0.36	3%	381.90	0.22	0%
Cambodia	4,259.67	462.60	11%	525.79	70.43	13%
Indonesia	11,400.43	584.41	5%	11,646.88	747.39	6%
Lao PDR	155.04	17.22	11%	123.66	10.52	9%
Malaysia	20,132.69	519.66	3%	17,241.26	782.71	5%
Myanmar	1,203.27	130.93	11%	782.40	31.10	4%
Philippines	8,425.17	201.60	2%	5,726.38	218.80	4%
Singapore	36,191.40	923.09	3%	27,205.21	-	0%
Thailand	20,895.45	635.90	3%	19,281.67	1,271.44	7%
Viet Nam	33,850.04	1,610.11	5%	10,984.47	669.92	6%
Total	136,525.82	5,085.89	4%	93,899.63	3,802.51	4%

*Source: WTO Tariff data from http://tariffdata.wto.org/, author's calculation based on applying MFN rate at 2-digit HS code, * denotes countries with currently enjoy lower rates due to membership of GSP schemes, **denotes countries that will enjoy lower tariffs due to FTAs with the EU having been agreed*

In the case of non-agricultural exports, the potential gains are broadly similar in terms of the relative shares of total trade across the EU and ASEAN. Tariff costs as a share of total trade are lower than for agricultural exports, given that non-agricultural products typically attract lower tariff rates. Nonetheless, given the large volumes of overall trade for non-agricultural products, the savings from tariff reductions would be significant.

So, both the EU and ASEAN stand to gain from the elimination of tariffs. Of course, some ASEAN Member States already enjoy preferential rates, but these could expire as a result of economic development or political disagreements, in which case MFN rates would apply and therefore securing permanent liberalisation through an FTA is necessary for the long term.

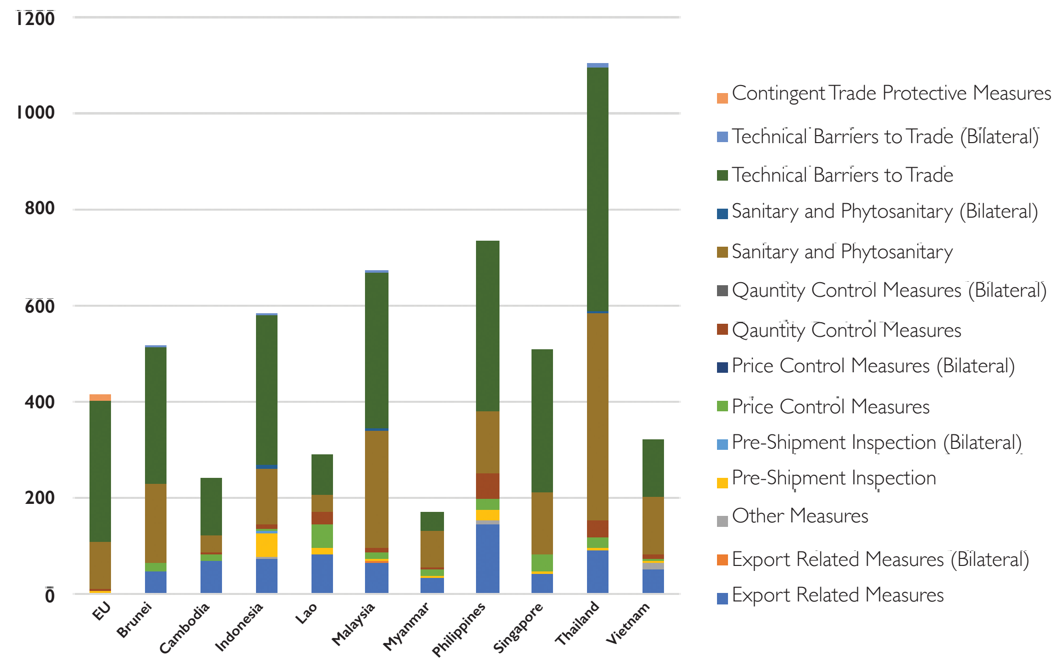
Non-Tariff Measures

More significant than potential tariff reductions would be the elimination of Non-Tariff Measures (NTMs) and Non-Tariff Barriers (NTBs). Tariff liberalisation is – in theory – more easily negotiated, and tariff levels have generally been falling globally as a result of multilateral and bilateral trade negotiations. However, alongside the reduction of tariff rates, evidence shows a growing propensity for the use of NTMs by many countries, which partially offsets the advancements achieved by lowering tariffs (Ronen, 2017). This trend can be seen clearly in the case of ASEAN where tariff rates have fallen significantly in recent years but the number of NTMs have risen at an even faster rate (Ing et al., 2016). This is significant, as NTMs can often impose higher costs than their tariff equivalents. For example, during the EU-US negotiations on the Trans-Atlantic Trade and Investment Partnership (TTIP), the EU aimed to remove the US's 1.25% tariff on cars, but more important were the non-tariff barriers, which were estimated to add 26–27% to the cost of selling cars to the US (Berden and Francois, 2015). Not only are NTMs likely to be more restrictive, providing more protection to domestic producers, they are also opaque and more difficult to dismantle. In addition, NTMs are a moving target, as they can evolve to take on new forms as soon as they are targeted or dismantled.

In the case of the NTMs imposed by ASEAN, Ing and Cadot (2017) estimate that the compliance costs associated with technical barriers to trade (TBT) measures imposed by ASEAN countries on manufactured products range from an average of 2.8% for Cambodia to 5.7% in the case of Indonesia. They also find high compliance costs in the textile sector in Singapore (9.9%) and Malaysia (9.4%) and relatively high compliance costs in the automobile sector in Viet Nam (12.9%) and in Thailand (8.7%). These estimates underline the importance of reducing NTMs for EU exports. One example of how NTMs can cost exporters are the food-labelling requirements in Indonesia. Indonesian Consumer Protection Law (2000) requires all foodstuffs sold to Indonesian consumers to be approved and bear a registration number, but this procedure can take between 6 and 9 months, creating major challenges for EU food exporters (European Commission, 2018). A related issue is halal certification. The Indonesia-EU FTA, which is still under negotiation, has been addressing the issue of halal certification. In particular, the EU is concerned with the Indonesian Halal Product Guarantee Law No 33 of September 2014. The Law, scheduled to be fully enforced in 2019, requires mandatory Halal certification and labelling for the products within its scope in order to be placed in the Indonesian market. Halal certification is understandably a very important issue for Muslim countries, such as Indonesia and Malaysia, but complex certification systems can create barriers to trade.

From ASEAN's perspective, the EU also imposes significant barriers to trade. Nimenya et al. (2012) find that the tariff equivalents of EU food safety standards were 55% and 98% for imports of fresh peas from Zambia to the Netherlands and the U.K., respectively. They ranged from 39% to 64% for imports of green beans and avocados from Kenya and from 63% to 270% for imports of frozen fish fillets in EU countries from the East African Community. The equivalent costs would be different for ASEAN food imports, but the scale of the costs illustrates the potential burdens imposed by EU NTMs. Chart 1 below details the NTMs by category imposed by the EU and each ASEAN Member State.

Chart 1. Non-Tariff Measures in force by EU and ASEAN Member States, 2018



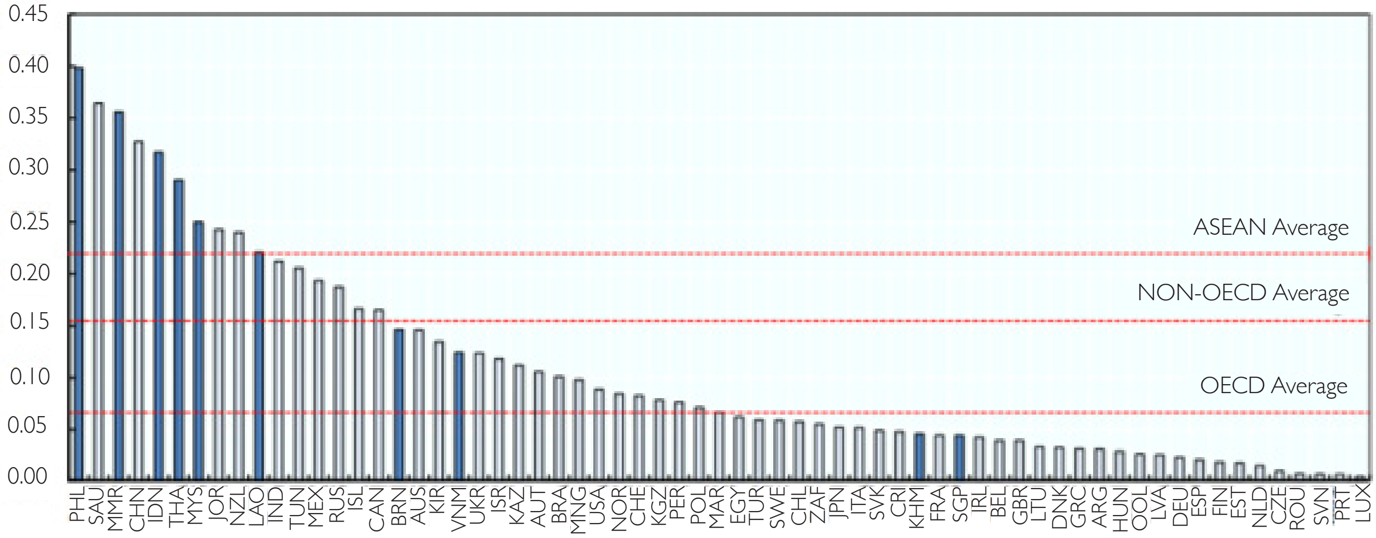
Source: UNCTAD TRAINS NTM database, accessed at https://trains.unctad.org/

So, looking beyond potential tariff reductions, an EU-ASEAN FTA could reduce the NTMs imposed on both sides, which would significantly reduce the cost and complexity of trade.

Services and investment restrictions

The EU is the largest source of FDI into ASEAN by a significant margin (ASEAN Investment Report, 2017). However, despite the significant inflows, there remain a number of restrictions in place, particularly in non-manufacturing sectors. According to the OECD's FDI Restrictiveness Index, six ASEAN Member States are now among the top ten most restrictive countries for FDI among the over 60 economies currently covered by the Index (OECD, 2018). The low scores are driven by restrictions in non-manufacturing sector, where ASEAN Member States tend to be more open. The OECD hypothesises that the relative success that ASEAN Member States have enjoyed in attracting FDI in the manufacturing sector has disincentivised reform in other areas.

There is significant diversity among ASEAN Member States when it comes to openness to investment, with with both Singapore and Cambodia being very open to investment. However, ASEAN as a whole is restrictive when compared to other regions as can be seen from Chart 2.



Source: OECD FDI Restrictiveness Index (2018)

ASEAN is also an important source of FDI for the EU. For example, UK utility Wessex Water is owned by Malaysian infrastructure conglomerate YTL Corporation. There are fewer restrictions faced by potential ASEAN investors in the EU, but they would still benefit from more secure arrangements. Investment agreements of this kind will become increasingly important as ASEAN continues to develop and export, as well as import, capital.

Investment restrictions are most significant in service sectors, which creates challenges for potential EU investors. This is not unique to ASEAN. In general, services liberalisation has lagged behind liberalisation of trade in goods, partly because trading services is inherently more complex. Resistance to liberalising trade also arises in response to incumbent interests in these sectors, which often include State Owned Enterprises or Government Linked Companies (SOEs and GLCs). For example, in Malaysia foreign participation in the banking sector is heavily restricted, and the government also holds significant stake in all major retail banks (Gomez, 2018).

Within ASEAN, services trade has been liberalised under the ASEAN Framework Agreement on Services (AFAS). This process is now being taken forward through the ASEAN Trade in Services Agreement (ATISA), as part of the ASEAN Economic Community (AEC) Blueprint 2025. As a result of these efforts, significant improvements have been made, but across key sectors, including banking, distribution and transport services, restrictions remain, to the extent that, with the exception of air and maritime transport, AFAS commitments allow for more restrictions than those observed as standard among OECD countries (OECD, 2018). Table 5 below details the restrictions of foreign ownership imposed by domestic legislation across ASEAN.

Table 5. Foreign Ownership Restrictions in ASEAN for Banking, Distribution and Transport services

Country	Restriction
Banking	
Indonesia	Foreign ownership permitted up to 99%
Malaysia	Foreign ownership permitted up to 30% for commercial banks; 70% for investment or Islamic banks
Myanmar	Foreign ownership not allowed in retail banking; joint ventures required for corporate banking, full ownership only for banks servicing foreign companies in foreign currencies
Thailand	Foreign ownership permitted up to 25%
Vietnam	Foreign ownership permitted up to 30%
Distribution	
Indonesia	Foreign ownership limits vary from 49% to 100% depending on nature of activity
Lao PDR	Foreign ownership limits vary from 50% to 100% depending on registered capital
Malaysia	Foreign ownership prohibited in range of wholesale and retail distribution activities
Myanmar	Foreign ownership in convenience stores and mini-markets not permitted; retail and wholesale distribution only through joint-venture with Myanmar citizen/enterprises
Philippines	Full ownership requires minimum capital threshold
Vietnam	Foreign ownership above 51% in retail and wholesale forbidden for certain products
Air Transport	
Brunei	Air licences restricted to operators owned by Brunei or by a Brunei citizen; foreign shareholding in specialty air transport services is limited to joint-ventures where foreign capital does not exceed 49%
Indonesia	Foreign ownership permitted up to 49%, up to 67% for ancillary services
Lao PDR	Foreign ownership permitted up to 49% for freight transport
Malaysia	Effectively up to 49% (control must be directly or indirectly under Malaysian)
Philippines	Foreign ownership permitted up to 40%
Thailand	Foreign ownership permitted up to 60% - 75% in all transport and transport related services
Vietnam	Foreign ownership permitted up to 30%, airports and airport services limited to 49%

Country	Restriction
Maritime Transport	
Brunei	Foreign ownership permitted up to 40%
Indonesia	Foreign ownership permitted up to 49% international and domestic maritime and inland water transport; limited to 67% for related services
Lao PDR	Foreign ownership permitted up to 49% in freight support activities only
Malaysia	Foreign ownership permitted up to 49% for cabotage; no restriction on international transport
Philippines	Foreign ownership permitted up to 40%
Singapore	Foreign ownership permitted up to 49% for ports (shares in PSA Corporation)
Thailand	Foreign ownership permitted up to 60% - 75% in all transport and transport related services
Vietnam	Foreign ownership permitted up to 49% for cabotage and international passenger services' no restriction for international freight
Rail & Road Transport	
Brunei	Foreign ownership permitted up to 49%
Indonesia	Foreign ownership permitted up to 95% for rail, up to 49% for road (95% for toll roads)
Lao PDR	FDI prohibited in domestic urban transport; up to 49% for international road freight
Myanmar	Foreign ownership permitted up to 40%-49%
Philippines	Foreign ownership permitted up to 40%
Thailand	Foreign ownership permitted up to 60% - 75% in all transport and transport related services
Vietnam	Foreign ownership permitted up to 49% for road; up to 51% for rail

Source: OECD Investment Policy Reviews: South East Asia (2018)

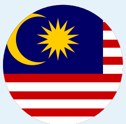
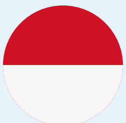
The EU and its Member States are generally more open to investment (as per Chart 2), However, on 20 November 2018 the EU agreed draft legislation to provide additional screening of foreign investment projects (Bloomberg, 2018). The framework is designed to ensure that the EU and its Member States can protect their "essential interests". It is not clear what impact this new framework will have on EU openness to FDI and it is understood that that this policy shift in broadly in response to concerns over the extent of Chinese investments, rather than from ASEAN. However, securing preferential access for ASEAN investors through an EU-ASEAN FTA would provide additional certainty.

Further liberalisation of investment policies across ASEAN through an EU-ASEAN FTA would benefit the EU and ASEAN though increasing opportunities for EU investors and increasing the stock of FDI across ASEAN and facilitating greater trade in services. It would also provide additional certainty for ASEAN investors in the EU, at a time when there are signs the EU will introduce additional barriers for foreign investors.

Public Procurement and Competition

In a similar vein to the restrictions on investment and services, ASEAN Member States also operate restrictive policies with respect to public procurement. This is an area of particular priority for the EU, given the large number of leading EU infrastructure and utilities companies. Table 6 below details the restrictions applied by Malaysia, Indonesia, Thailand and the Philippines on foreign companies pursuing public procurement contracts,

Table 6. Procurement Restrictions in Malaysia, Indonesia, Thailand and the Philippines

Country	Procurement Policy Restrictions
 **Malaysia**	• Malaysia has traditionally used government procurement contracts to support national public policy objectives, including: - encouraging greater participation of Bumiputera (the majority Malay ethnic group) in the economy, - transferring technology to local industries, - reducing the outflow of foreign exchange, - creating opportunities for local companies in the services sector, and - enhancing Malaysia's export capabilities. • Invite international tenders only when domestic goods and services are not available, and in those cases, foreign companies often find they need to take on a local, Bumiputera qualified partner before their tenders will be considered.
 **Indonesia**	• Indonesia grants special preferences to encourage domestic sourcing and to maximize the use of local content in government procurement. • Government departments, institutes, and corporations are instructed to utilize domestic goods and services to the maximum extent feasible. • Presidential regulations (38/2015 & 54/2010) require procuring entities to seek to maximize local content in procurement, use foreign components only when necessary, and to designate foreign contractors as subcontractors to local companies. • Depending on the sector or nature of the project, ministries with authority over the project may impose additional restrictions or requirements. • Presidential Regulation 2/2009 stipulates that all state administrations should "optimize" the use of domestic goods and services and give price preferences for domestic goods and providers.

Country	Procurement Policy Restrictions
Thailand	• The Prime Minister's Procurement Regulations, which govern public sector procurement, came into effect in 1992 and revised several times. • These regulations established a preference program in which products certified by the Ministry of Industry as supplied from domestic suppliers have an automatic 7% advantage over foreign bidders in evaluations in the initial bid round.
Philippines	• Five different restrictions in Philippine laws dating back to the "Flag Act" of 1936, where, Philippine nationals or Filipino-controlled enterprises are favoured for procurement contracts. • Domestic goods also enjoy preferential treatment over imported products in the bid evaluation process. • Eligibility requirements specify minimum Filipino ownership requirements for suppliers/contractors of goods (60 percent), infrastructure (75 percent), and consulting services (60 percent). • A 1993 executive order directs government departments and agencies, including government-owned and controlled corporations, to negotiate countertrade arrangements equivalent to at least 50 percent of the value of supply contracts exceeding $1 million for the purchase of foreign capital equipment, machinery, materials, goods, and services.

Source: USTR Trade Barriers Report 2018

Negotiating reductions of these restrictions through an EU-ASEAN FTA would create significant opportunities for EU firms. From an ASEAN perspective, the EU's procurement policies have traditionally been viewed as relatively open and free from "buy local" requirements. However, the European Commission has been developing a new International Procurement Instrument which is designed to protect EU companies from uncompetitive practices. As a last resort, under the instrument, the European Commission would be able to impose a price penalty on tenders originating in the third country concerned (European Parliament, 2017). The importance of securing an FTA is therefore likely to increase for ASEAN Member States wishing to retain open access to the EU's procurement markets.

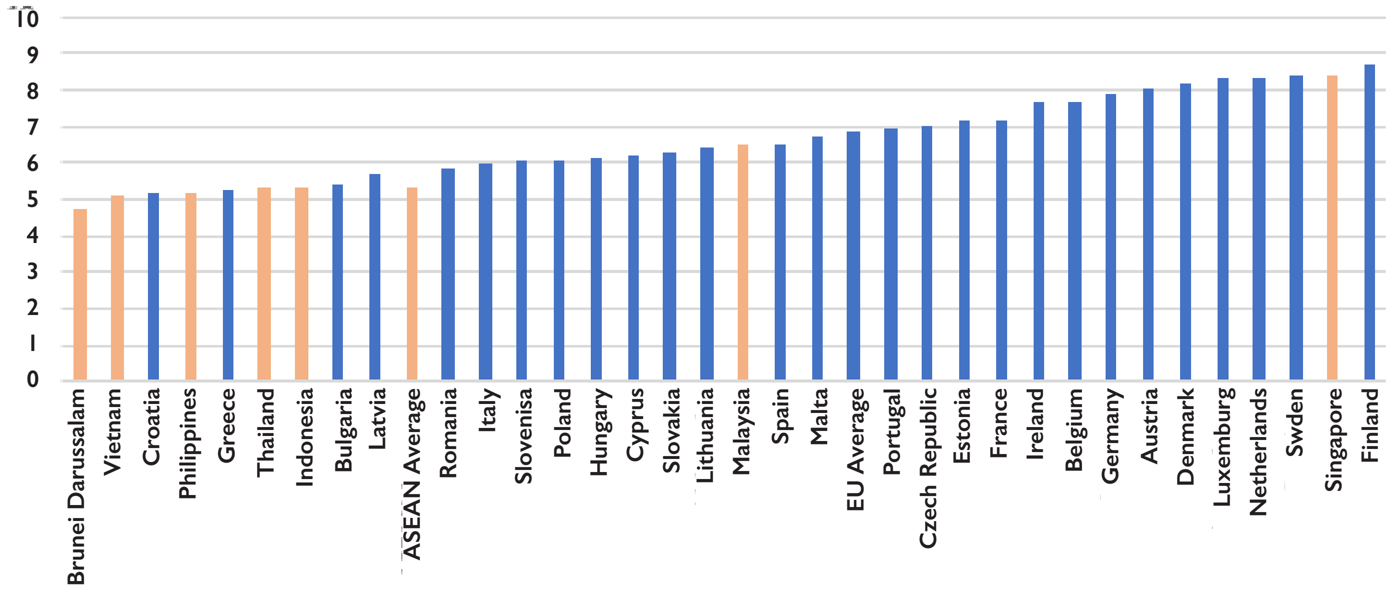
Ensuring a more competitive market for EU and ASEAN contractors in the public procurement market would be a significant benefit of an EU-ASEAN FTA. It would create opportunities for firms in both regions, and the greater competition for public contracts would encourage lower costs for the taxpayer along with higher quality.

Intellectual Property Rights

Protection of intellectual property rights (IPR) is another area which could be improved through agreement of an EU-ASEAN FTA. Strong IPR standards provide businesses with certainty that the integrity of their IP will be protected and they will be farily rewarded for their work.

As illustrated in Chart 3 below, ASEAN Member States rank on average lower than EU counterparts., with respect to IPR standards. according to the International Property Rights Index (2018).

Chart 3. IPRI Scores for ASEAN and EU, 2018



Source: IPRI 2018

Specific concerns relate to legislation in some Member States which grant their respective governments the power to use inventions under certain circumstances. This is often associated with the compulsory licensing of medicines, invented and produced by pharmaceutical companies. In Malaysia, the patent law has a special provision for "Rights of Government" which authorizes the government to "make use and exercise any invention", subject to the payment of "reasonable compensation" (Rights of Government under Patent Act 1983 (Act 291)). In the Philippines, the relevant provision is "Use of Invention by Government," which allows the government to exploit an invention in the public interest, in particular national security (Republic Act No. 9502 Cheaper and Quality Medicines Act, 2008). In Indonesia, the relevant law is Law No. 14 of 2001 on Patents which was updated and amended and later came to be known as the as the New Indonesia Patent Law, 2016 which expanded the use of compulsory licenses.

Strengthening IPR standards through an EU-ASEAN FTA would provide businesses with increased certainty. Improvments in IPR would also benefit both EU and ASEAN Member States domestically, for example in healthcare, experience across the globe demosntrates that robust IPR standards are key to ensuring trade flows smoothly and also allow for innovation and investment within the healthcare sector (Mydin, 2016).

Non-trade benefits

In addition to the benefits for trade and the economy, there are important non-trade benefits that could be secured following agreement of an EU-ASEAN FTA. By agreeing to specific commitments on procurement, competition and SOEs, FTAs can help to improve governance, reduce rent-seeking and cultivate a fairer business environment. A report by the European Parliament concluded that "international free trade agreements exert a positive influence by increasing competition directly in the removal of tariffs and so diminishing the power of rentier companies which influence domestic regulation in their favour, and by contributing to a fairer business environment through their transparency provisions; in other words, by reducing the non-tariff barriers generally used to the advantage of domestically connected companies" (Mungiu-Pippidi, 2018).

A specific example of this is the improved governance of SOEs and GLCs. State-backed companies can enjoy uncompetitive advantages, which undermine effective competition (Saiful, 2017.) In some cases, close links between state-linked companies and the government can even result in corruption. As part of an EU-ASEAN FTA, certain safeguards could be introduced to improve transparency and fair competition.

The EU-Vietnam FTA contains ambitious provisions on SOEs (European Commission, 2016). This has been hailed as a significant achievement, as SOEs have traditionally been a backbone of Vietnamese economy and create approximately 40% of GDP.

Core Rules related to SOEs in EU-Vietnam FTA:

a. Rules applicable will put SOEs and private enterprises (PEs) on equal footing when engaged in commercial activities (especially with regards to subsidies).

b. Parties can request information on a case by case basis on corporate structure and finances of the companies.

c. Regulatory functions will treat SOEs and PEs in the same way and that all laws and regulations will be applied in a non-discriminatory manner.

Building on this precedent, the EU has set out its requirements in an explanatory note relating to FTA negotiations with Indonesia. The EU proposes "to negotiate rules regarding state-owned enterprises (SOEs), designated monopolies (public and private) and enterprises granted special rights or privileges … in order to ensure that trade liberalisation achieved by the Agreement is not undermined by the unfair behaviour of such companies. The objective of these rules is to put private enterprises on an equal footing with enterprises where the governments are involved" (European Commission, 2017).

As noted above, an EU-ASEAN FTA would also be expected to include reforms of procument policies to ensure greater competition. Aside from the economic benefit of greater compeition, reforms could also result in improve governance and greater transparency of public procurement. Regretably, procurement policies have often been associated with patronage, as rent-seeking interests are able to extract value from governemnt contracts, and in some case lead to corruption (Stolfi and Murniati, 2014).

Ultimately, issues such as SOE governance and procurment will remain domestic policy matters, but an EU-ASEAN FTA could help encourage and promote reforms that would encourge greater transparency and competion at home as in additionn to greater trade abroad.

Finally, a region-to-region agreement between the EU and ASEAN would also have wider geopolitical significance. Both regions represent attempts to integrate economically and both regions benefit from trade and investment. As a result, both regions have broadly supported a multilateral rules-based system – for example it is ASEAN which is currently negotiating the world's largest trade deal, the Regional Comprehensive Economic Partnership (RCEP). If the world's two largest regional blocs were able to agree a comprehensive free trade agreement, that spanned the most and lesser developed Member States in both Europe and Asia, it would send a positive signal on the strength of the rules-based international trading system, at a time when it is coming under some pressure. From both region's perspectives, it would also diversify trading relationships, thus improving resilience at a time of global uncertainty.

Challenges to Agreeing an EU-ASEAN Free Trade Agreement

Despite these significant benefits, there remain a number of major challenges to securing an EU-ASEAN FTA, including the same issues that forced a suspension in the negotiations before.

- **Co-ordination of ASEAN interests.** ASEAN continues to operate on a decentralised model which is consensus-based by design. As a result, reaching a common position among Member States will remain challenging. This is compounded by the relatively low-resourcing of the ASEAN Secretariat (at least in comparison to the European Commission), which reduces ASEAN's negotiating capacity. However, since the original EU-ASEAN FTA, ASEAN has negotiated or is negotiating other major trade deals, such as RCEP, and therefore its ability to co-ordinate position across its Member States has improved.

- **Concern over adjustment costs on both sides.** Although an EU-ASEAN FTA would result in an overall increase in economic output and employment as a result of increased trade, there would also be a reduction in output and employment in some sectors subject to a higher degree of competition. In general the benefits of freer trade are dispersed widely across the population in terms of lower prices and underlying increases in productivity growth. However, the negative adjustment can be focussed in particular sectors, which can result in some segments of the population being highly motivated to resist a deal. This is a legitimate concern that will be raised from both EU and ASEAN stakeholders. From both the perspective of the EU and ASEAN, it is therefore important to ensure the right policies are in place to ensure that business and workers can adjust smoothly and enjoy the benefits of freer trade.

- **Concerns over industrial development in ASEAN.** A number of the protectionist policies outlined in this paper are designed to protect domestic industries in ASEAN Member States. Some Member States will continue to see these policies as necessary to support development of strategic industries and may therefore be unwilling to offer significant liberalisation as part of negotiation of an EU-ASEAN FTA, particularly where those sectors would be subject to significant additional competition.

- **Concerns over public policy freedom in ASEAN.** Another source of concern for ASEAN Member States is the risk that far-reaching liberalisation impedes on their ability to deliver public policy priorities, beyond industrial development. For example, some ASEAN Member States have expressed concerns that IPR commitments would impede their ability to provide low cost medicines, which currently rely on compulsory licensing regimes. Public policy objectives may also relate to cultural factors, for example maintaining very high halal certification standards, even if this is burdensome for international companies.

- **Role of the state in the economy in ASEAN.** As noted earlier, an EU-ASEAN FTA is likely to include commitments of SOEs aimed at ensuring fair competition. However, such commitments challenge the accepted norms on the role of the state in the economy in some ASEAN Member States. This can include developing strategic industries, stewarding national resources or delivering on socio-economic objectives, such as increasing employment for a certain segment of the population. Many ASEAN Member States view the role of these SOEs as crucial to economic and social development, so agreeing commitments to fair competition will be challenging.

- **Concerns over trade and development.** These protectionist instincts have been strengthened by recent concerns over the negative impact of trade for development (for example, see UNCTAD Trade and Development Report 2018). This has also been reflected in ASEAN Member States, particularly as a concern of negotiating trade deals with more developed countries. For example, Prime Minister Mahathir has urged caution about striking unfair deals (Bernama, 2018) and has raised concerns over the recently negotiated Comprehensive and Progressive Trans Pacific Partnership (CPTPP). Although its important to note that Prime Minister Mahathir used the same appearance to advocate Free Trade Agreements such as RCEP. Nevertheless, these concerns about "uneven" FTAs might hinder efforts to secure a far-reaching EU-ASEAN FTA.

- **EU environmental standards** The EU's environmental concerns will continue to pose a challenge to negotiations both bilaterally and at the region-to-region level. This is particularly stark in the case of palm oil, which is a major national industry for both Malaysia and Indonesia.

- **Political challenges.** EU concerns over the political situation in some Member States will remain a challenge. Democratic elections in Thailand are a pre-condition for negotiations and the EU has separately launched reviews in Cambodia and Myanmar with a view to excluding both from the EBA preference scheme over political rather than economic considerations. If these political situations remain unchanged, it will be difficult to conlude a region-to-region agreement.

- **Lack of flexibility from EU.** The EU will be unwilling to make significant compromises on these issues: depth of liberalisation, environmental and political concerns. The European Commission will be subject to strong scrutiny on these points, including from the European Parliament. The EU is therefore unlikely to be highly flexible on these points., making a compromise agreement more difficult to reach.

- **Relative expediency of bilateral deals from the EU's perspective.** Partly as a result of these challenges, the EU has considered bilaterally negotiated deals with individual Member States as the more expeditious route to improving trade relations with ASEAN. Given the availability of this option, and the additional challeges of striking a regional level agreement, there is a risk that these deals continue to be prioritised over an ASEAN-wide deal.

Table 7. Summary of Benefits and Challenges for potential EU-ASEAN Free Trade Agreement

Issue	Benefits	Challenges for a Deal
Tariff Liberalisation	Reduced cost of trade on both sides	Concerns over impact on domestic industrial development in ASEAN
NTM Reductions	Reduced cost and complexity of trade on both sides	Concerns over impact on domestic industrial development in ASEAN Difficulty in addressing measures linked to public policy objectives (e.g. environmental, cultural)
Investment and Services	More opportunities for EU to invest in ASEAN sectors and vice versa Increased FDI to both ASEAN and EU, leading to greater competition and innovation	Concern over giving foreign investors too much influence, including in key sectors (e.g. banking), leading to loss of "sovereignty"
Procurement and Competition	More opportunities for EU companies to bid for contracts in ASEAN and vice versa Level playing field for foreign and domestic firms	Unwillingness to reform procurement policies which are designed to deliver strategic economic and social objectives
Intellectual Property	More certainty for EU business operating in ASEAN and vice versa	Concern over loss of ability to achieve public policy objectives (e.g. compulsory licensing of medicines) Insufficient capacity to enforce IP standards in some countries
Governance	Improved governance of State-Owned Enterprises in ASEAN Greater transparency and competition in public procurement in ASEAN	Unwillingness to reform the role of the state in the economy, which is justified by strategic economic and social objectives. Entrenched interests resistant to reforms
Geopolitical	Strengthen the international rules-based trading system	Conflicting political objectives and priorities reduce likelihood of reaching common political agreement

Conclusion

In this report we have considered the potential benefits of an EU-ASEAN FTA and the challenges that will arise when trying to reach an agreement. Our conclusions are summarised below:

- **ASEAN and the EU share a long standing and important economic and political relationship**. The two regions share important trade and investment links and as the world's two largest economic blocs, they have much to gain from ongoing cooperation.

- **This relationship could be further strengthened through agreement of a region-to-region, EU-ASEAN Free Trade Agreement (FTA).** A comprhensive FTA would involve reduction in tariffs; simplification of Non-Tarrif Measures (NTMs) and and Non-Tariff Barriers (NTBs); liberalisation of investment and services; improved public procurement and stronger Intellectual Property Rights (IPR). Such an agreement would deliver signifcant economic benefits on both sides, as a result of increased trade and stronger compeition domestically.

- **An EU-ASEAN FTA would also deliver non-trade related benefits.** Competition and procurement reforms will improve transparency and governance in ASEAN Member States, including in relation to State Owned Enterprises (SOEs). A region-to-region deal between the world's two largest trading blocs would also send a postiive signal about the strength the rules-based international trading system.

- **There are number of challenges to securing an EU-ASEAN FTA that will need to be addressed for progress to be made.** Coordinating positions among ASEAN Member States will remain a challenge. More importantly, securing meaningful liberalisation will require addressing concerns over industiral development, public policy freedom and the negative adjustment associated with increased competition.

- **In the short term, the challenges with agreeing a region-to-region agreement mean that the EU should continue to pursue bilateral agreements with ASEAN Member States.** The challenges are significant and agreeing bilateral deals remains a sensible strategy to ensure that progress is accelerated where possible.

- **However, these bilateral agreements should be considered as building blocks to a broader region-to-region agreement.** Ultiamately the long term goal should remain an EU-ASEAN FTA, to ensure the full potential of the EU-ASEAN relationship can be realised. Crucially, this will require sustained efforts to address the challenges associated with securing an agreement of this magnitude, to ensure that the benefits can be enjoyed by citizens in the EU and ASEAN alike.

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