Journal of Asian Economics 35 (2014) 12–31

Contents lists available at ScienceDirect

Journal of Asian Economics

The impact of AFTA on intra-AFTA trade[☆]

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ARTICLE INFO

Article history:
Received 29 November 2013
Received in revised form 23 September 2014
Accepted 28 September 2014
Available online 8 October 2014

Keywords:
ASEAN Free Trade Area
Intra-regional trade
Gravity model
Trade creation effect

F13
F15
O19

ABSTRACT

ASEAN countries have liberalised intra-ASEAN trade over the last 20 years by establishing the ASEAN Free Trade Area (AFTA). This paper aims to examine the impact of trade liberalisation under AFTA on intra-ASEAN trade. By applying a gravity model, we find positive and significant trade creation effects from the tariff elimination for a wide range of products. In addition, the analysis reveals that the elasticity of tariff reduction on imports tends to be much larger than that on exports. Trade creation effects for the new ASEAN members are relatively small compared to those for the old members. Our results show that AFTA has been successful in promoting intra-AFTA trade, while we argue that further expansion may be achieved by increasing the use of AFTA and by reducing/removing non-tariff measures (NTMs) through such ways as improving customs procedures and harmonizing/mutually recognizing product standards.

1. Introduction

The member countries of the Association of Southeast Asian Nations (ASEAN) embarked on the formation of a free trade agreement (FTA) under the name of ASEAN Free Trade Area (AFTA) in 1993.[2] Several motives behind the establishment and implementation of AFTA may be discerned. First, ASEAN policy makers thought that an expansion of intra-ASEAN trade would promote economic development of the ASEAN countries as the expansion of exports would result in output growth and the expansion of imports would improve productive efficiency. In particular, the creation of a large unified ASEAN market through AFTA would enable producers in ASEAN to exploit the benefits arising from the economies of scale.[3] Second, a rising trend of regional trade agreements (RTAs) in the world, which include FTAs and customs unions, put pressure on

☆ The authors would like to thank the Editor Michael G Plummer, Co- edithor Yoshifumi Fukunaga and an anonymous referee for their insightful comments and detailed suggestions. The authors are also grateful to Ponciano S. Intal, Jr. and Dionisius A. Narjoko for their valuable comments on an earlier version of this paper.

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2 AFTA was signed in 1992 and it was enacted in 1993.

3 According to the ASEAN secretariat, "the objective of AFTA is to increase the ASEAN region's competitive advantage as a production base geared for the world market. This activity has begun to serve as a catalyst for greater efficiency in production and long-term competitiveness. (http://www.asean.org/communities/asean-economic-community/item/asean-free-trade-area-afta-an-update). Also, see the objectives for "Framework Agreements on Enhancing ASEAN Economic Cooperation" declared on January 28, 1992 in Singapore. (http://www.asean.org/communities/asean-economic-community/category/asean-trade-in-goods-agreement).

http://dx.doi.org/10.1016/j.asieco.2014.09.004
1049-0078/

ASEAN members to form an FTA, as they saw that such a trend would result in discrimination against their products in their export markets. Faced with difficulties in multilateral trade negotiations in the Uruguay Round of trade negotiations under the auspices of the General Agreement on Tariffs and Trade (GATT), many countries in the world including European countries and the United States turned to RTAs with like-minded countries in order to obtain the benefits of trade liberalisation.[4] Third, the Asian financial crisis in 1997–1998 increased momentum to regional economic cooperation in this region. Tariff elimination under AFTA was accelerated in order to strengthen the economic stability and attract further foreign direct investment from outside region.[5] AFTA began with six ASEAN members, namely Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand, and then it was joined by Vietnam in 1995, Lao PDR and Myanmar in 1997, and Cambodia in 1999. At the time of writing, AFTA has 10 members.

A pillar of trade liberalisation under AFTA is the Common Effective Preferential Tariff (CEPT) Scheme to eliminate tariffs on intra-AFTA trade, which have been in effect since January 1993. The AFTA members set the target years for tariff elimination to be completed under the CEPT, as will be explained in detail in the following section. By 2010, more than 99% of the tariff lines in the CEPT Inclusion List had been eliminated in the six original AFTA members, while around 95–99% of the tariff lines had been brought down to the 0–5 percentage tariff range for the new members.

In the light of notable achievements in trade liberalisation under AFTA, we attempt to analyse the impact of AFTA on trade among the AFTA member countries. Specifically, we are interested in whether AFTA has promoted trade among the AFTA member countries, as was expected before the establishment of AFTA. We undertake the analysis using two approaches – descriptive and econometric approaches. First, we examine the changing patterns of intra-regional trade in ASEAN from the 1980s to 2010 by using regional trade data at both aggregated and disaggregated levels. Second, we conduct regression analyses by applying a gravity model to bilateral trade flows in order to examine the impact of the elimination of tariffs under the CEPT Scheme for AFTA on trade flows at product level by controlling the factors other than tariff elimination such as transportation cost, and the economic environment of exporters and importers.

The remainder of this paper is composed as follows. Section 2 reviews the process and the current status of the tariff eliminations under the CEPT Scheme for AFTA. In Section 3, the changing patterns of intra-AFTA regional trade flows are examined by using aggregated and disaggregated trade statistics, in order to set the stage for the statistical analysis. Section 4 examines the impact of the elimination of tariffs under the CEPT Scheme on bilateral exports and imports of the AFTA members by applying a gravity model using trade data at product level. We mainly focus on the trade creation effect of tariff elimination under the CEPT. Section 5 provides some concluding comments including policy implications.

2. Tariff elimination under the CEPT Scheme for the AFTA

Tariff reduction by the AFTA member countries proceeded along the lines of the CEPT Scheme. Under the CEPT Scheme, products are initially classified into two groups; Inclusion List (IL) and Exclusion List (EL). Those products in IL were subject to tariff elimination while those in EL were excluded from tariff elimination. The Exclusion List was later subdivided into a Temporary Exclusion List (TL) and Sensitive List (SL) in 1995. The products in TL will become subject to tariff reduction or elimination in the future, and will be shifted to IL. The products under SL were exempted from tariff elimination.

For the original AFTA members, initially, tariff rates on the products in IL were scheduled to be reduced to between 0% and 5% by 2008. The tariff reduction schedule was revised in 1994 and 1998, and the due date of tariff reduction to the 0–5% range for the products in IL was moved to 2002. For the new AFTA members the due dates were set as follows; 2006 for Vietnam, 2008 for Lao PDR and Myanmar, and 2010 for Cambodia. Products in TL have been shifted to IL annually from 1996. For the products in SL, including unprocessed agricultural products, the tariff rates were to be reduced to the 0–5% range by the year 2010 for the original six members and by the period 2013–2017 for the new members.

The ASEAN–CEPT agreement was revised significantly by the ASEAN Trade in Goods Agreement (ATIGA) signed in December 2008. In the revised schedule, the tariff rates of the products in IL were to be reduced to 0% by the year 2010 for the original six members and by the year 2015 for the new members. ATIGA also redefined the detailed schedule of tariff reduction.[6]

Intra-regional tariff rates in ASEAN have been reduced or eliminated steadily under the CEPT Scheme, which was revised several times. By 2010, the share of the total number of products with the 0% tariff rate, in terms of tariff lines, was around 99% for the original six countries, while the share of products with the 0–5% tariff rates was around 99% for Cambodia, Myanmar and Vietnam and 95% for Lao PDR. Judging from these figures, one may confirm that the process of regional tariff reduction or elimination in the ASEAN member countries has proceeded strongly in the last 20 years, and has almost been completed.

[4] Tan (1996) discusses global and regional trends as a driving force behind forming AFTA including the emergence of economic blocs in Europe and North America. Naya and Iboshi (Imada and Naya, 1992) point out that formation of regional economic bloc such as the EC and NAFTA presented a challenge to ASEAN.

[5] Plummer (2006) provides a review of economic and political environment behind AFTA in the context of economic integration in Asia. He suggests several factors influencing the regionalism trend in East Asia that stem directly from the Asian financial crisis.

[6] The tariff reduction and elimination schedule was categorised into eight groups from Schedule A to H. The tariffs on the products in Schedule A were to be eliminated by 2010 for the six members and by 2015 for Cambodia, Lao PDR, Myanmar and Vietnam (hereafter CLMV); Schedule B indicates tariff reduction on information and communication technology (ICT) equipment for CLMV; schedule C is for priority integrated sectors (PIS) products for CLMV, whose tariffs were to be eliminated by 2012; Schedules D and E include unprocessed agricultural products; Schedule F defines the out-quota tariff rate for Thailand and Vietnam; Schedule G is for petroleum products (PP) for Cambodia and Vietnam; and Schedule H is for General Exceptions (GE).