Free trade agreement between the gcc and asean

Executive Summary

This paper is a consolidated report of surveys on key issues and concerns to trade and investment in an ASEAN-GCC free trade environment. The researchers were able to make a schema of most likely issues and concerns that would be deterrent to negotiations for a free trade agreement on the ASEAN and GCC zones.

The consolidated report is based on an intensive literature review. As the ASEAN-GCC talks are still underway, the researchers thought it wiser to first create a schema for an enterprise survey which would assess the effectiveness as well as determine barriers which would inadvertently affect ASEAN-GCC free trade negotiations.

A consolidated report on such factors would greatly benefit business enterprises as well as the government itself in that it provides a guidelines of expectations and, thus, this could be addressed early on.

The report first discussed an overview of the GCC financial market to establish the market potentials and capacity of the region. The key issues and concerns that were gathered through research were then grouped accordingly to whether they fall under the tariff barriers or formal transaction cost issue, and the non-tariff barrier (NTB) or informal transaction cost issues.

From the consolidated report, it was revealed that while tariff barriers or formal transaction costs affects trade and investment, it was the non-tariff barriers which generally costs companies a lot. Non-tariff barriers include red

tape from getting business certifications, weak legal system especially in legal disputes and the like, enforcement of environmental policies, restrictions placed on ownership of equities and real estate, existence of laws which prohibits foreign nationals from applying for business permits, especially in areas outside the free trade zone. There also exists some political and/or diplomatic barriers. However, these should not be given to much focus as these contribute only a small amount of influence to the conduct of trade and investment.

Area of Study

This study on the free trade agreement between the ASEAN and GCC focuses on identifying issues and concerns that should be addressed in order for a free trade agreement between the GCC and the ASEAN to be useful and beneficial for all signatory parties. These issues and concerns are identified through extensive research and inference from previous studies and factual articles. However, issues that are only significant for the government and other stakeholders, but are not of particular important to the business sector (i. e., labor and environmental issues) were not considered.

Background of the Problem

Last June 30, 2009, a trade pact in the form of a memorandum of agreement (MOA) was signed between the Gulf Cooperation Council (GCC) and the 10 country-members of the Association of Southeast Asian Nations (ASEAN) (TradeArabia, 2009). The said MOA focuses on building a trade bloc between the GCC and ASEAN, and also explores the possibility of a Trade and Investment Framework Agreement (TIFA) and a free trade agreement (FTA). The trade pact was signed after the first successful GCC-ASEAN ministerial meeting held in Manama, Bahrain, wherein the ministers approved a two-year working plan in improving trade relations between GCC and ASEAN countries (TradeArabia, 2009; ArabNews. com, 2010). A trade and investment road map in the form of the GCC-ASEAN 2010-2010 action plan was adopted on the second GCC-ASEAN ministerial meeting held in Singapore in May 2010 (ArabNews. com, 2010; Press Trust of India/bilaterals. org, 2010; The Malaysian News Agency, 2010).

In an article by the Press Trust of India (2010) as cited by bilaterals. org (2010), the GCC and ASEAN have agreed to further enhance trading and investment opportunities as well as collaboration in the areas of improving the economy, commercial and business enterprise, education whilst promoting mutual respect through culture and media by way of the ASEAN-GCC Two-Year Action Plan (2010-2012) . However, in the recent press release of the ASEAN Secretariat (www. asean. org, 2010) a free trade agreement between the two blocs was not brought up.

Business Dictionary defines “ free trade agreement” as a treaty between countries that essentially reduces tariffs and barriers on goods and services, although capital and/or labor may not move freely (businessdictionary. com). These agreements specify the rules and for trade between or among signatory countries (Sen, 2004, p. 1).

Free trade means trade of goods and services (not necessarily capital and labor) between countries that is “ free” from tariffs and other trade barriers imposed by the governments of those countries (Bhagwati, 2002, p. 3). It is considered as the building block for economic integration in a region (Sen, 2004, p. 1). Free trade is based on the principle of “ comparative advantage” first proposed by David Ricardo (Case & Fair, 1999, pp. 812-818). Ricardo’s theory of comparative advantage asserts that countries could produce goods more efficiently if they specialized at producing the good(s) which they produce most efficiently and bought all other goods from other nations specializing in producing those goods (Case & Fair, 1999, pp. 812-818). According to this theory, specialization will make production of goods more efficient and thus, bring down prices. Therefore, if goods can freely enter a country, advocates of free trade suggest consumers would benefit because of the lower prices of goods (Case & Fair, 1999, p. 818).

WTO and other reports have stated that free trade agreements have started to proliferate between countries and even between trading blocs (Crawford and Fiorentino, 2005, p. 2; Razeen, 2006). Of regional trade agreements reported to the WTO as of 2005, 84 per cent are free trade agreements (Crawford and Fiorentino, 2005, p. 3). The WTO reports that the uncertainty of the fate of the Uruguay Round (1986-1994) has prompted countries to pursue their own preferential deals, mostly bilateral, or involving two countries, with other nations (Crawford and Fiorentino, 2005, p. 6).

The more aggressive countries or trading blocs are the European Union, Australia, Japan, Singapore, New Zealand, and the United states and Canada. The ASEAN and the GCC are both lagging behind in creating deals, but the member countries, particularly of the ASEAN are forging their own FTAs with other countries such as Japan, South Korea, and China (Crawford and Fiorentino, 2005, pp. 6-8).

It has been observed that trade among the Arab states has been relatively small compared to other regions (Hassan and Tarik, 2010). This is despite the observation that members of the GCC have common economic and social characteristics (Fasano and Iqbal, 2003). But the GCC is trying to catch up with regard to forming free trade agreements – as a bloc – with other countries and trading blocs (Hassan and Tarik, 2010). It has signed a free trade agreement (GSFTA) with Singapore in 2009 and has since experienced a growth in investments from – and an increase in trade – with this country.

The GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates and was formed in May 1981 (Fasano and Iqbal, 2003). Its aim is to promote cooperation and peace among member nations. The member countries of the GCC have all undergone diversification from dependence on oil into trade and services-centered economies. The GDP per capita in these countries are among the highest in the world (Fasano and Iqbal, 2003).

The members of the ASEAN, however, have followed a different track. Instead of forming free trade agreements as a bloc, each individual member of the ASEAN has began to forge free trade agreements with other countries such as Japan, South, Korea, the United States, and Australia (Razeen, 2006). Singapore is the most aggressive of these countries, having signed a free trade agreement with the GCC in 2009 (iAdvisory, 2009). However, the region has started talks – as a bloc – for free trade agreements with China, Australia New Zealand, and the GCC (China Embassy, 2004; Xinhua, 2008; Tradearabia, 2009).

The ASEAN was formed in 1967 in Bangkok, Thailand through the signing of the ASEAN Declaration by the five founding members, namely: Indonesia, the Philippines, Malaysia, Thailand and Singapore. It was later joined by Brunei Darussalam in 1984, Vietnam in 1995, Lao PDR and Myanmar in 1997, and finally, Cambodia in 1999. Thus, today ASEAN has ten member countries (ASEAN website).

With the signing of the memorandum of agreement between the GCC and ASEAN for in 2009 (Tradearabia, 2009) and the adoption of the ASEAN-GCC Two-Year Action Plan in 2010, trade and finance officials in these two regions are still on the verge of devising such an agreement that would be agreeable to all involved. The Joint Vision in 2009 built the economic partnership between the two regions on the following areas: economic, cultural, scientific and social, and aims to promote people-to-people contacts. On the other hand, the two-year action plan expands its cooperation and collaboration along the areas of " trade and investment, economic and developmental cooperation, education and training, culture and information, and mutual consultation in international matters" (ASEAN Secretariat, 2010).

Research Objectives

The researchers believe that this paper would be timely as it attempts to point out possible key issues and concerns that the business enterprise might come up against in operating within the GCC. It is a fact that business organizations and companies are the driving forces behind trade. Thus, the point of view of these organizations will have to be considered for a free trade agreement to prosper.

Therefore, the purpose of this paper is to identify possible issues and concerns that should be addressed in order for a free trade agreement between the GCC and the ASEAN to be useful and beneficial for all signatory parties. Issues that could be significant for the government and other stakeholders, but are not of particular important to the business community (for example, labor and environmental issues), will not be considered.

Expected Outcome

Through this research, we hope to uncover key issues that are seen by businesses in both the ASEAN and the GCC as roadblocks to free trade between the two regions. We anticipate that lack of information about each other's markets, and the convoluted regulatory policies of each region will be primary concerns. Also, the unification of standards for export products, particularly in the electronic sector may be another crucial issue. These concerns will be discussed in detail. The literature will also be consulted for possible solutions on how to address the issues. Such possible solutions will be incorporated in the conclusion and recommendations portion of the paper.

Methods of Examination

Literature Review

Due to time constraints, the researchers opted to use literature review as a method for identifying key issues and concerns in the GCC-ASEAN free trade agreement, particularly with regard to trade and other aspects that affect it – such as cultural, political, and social environments, will be reviewed in order to identify possible issues and challenges that would be stumbling blocks to reaching a beneficial trade agreement.

Research and statistical material on the effects of free trade agreements forged by GCC with other countries, regions, or trading blocs will also be examined to determine issues that have emerged, if any, in these free trade agreements. The same shall be made with regard to the agreements forged by the ASEAN and its member countries with other nations or trading blocs.

Techniques and Strategies Used

Descriptive analysis such as frequency counts, means, percentages and was used in describing the consolidated report about the identified key issues and concerns surround the GCC-ASEAN free trade agreement. These literature were gathered from published journals, news articles, magazine articles, e-zine and the like. The need to consolidate the information gathered from these materials are very important in order to show a general picture of the key issues and concerns plaguing the business enterprise operating within the GCC-ASEAN free trade agreement. And, thus, inference can be drawn.

From the consolidated report, a conceptual framework could be sufficiently drawn, providing a springboard for an intensive enterprise survey in order to assess the effectiveness of the GCC-ASEAN free trade.

Analysis and Findings

This section describes the literature review conducted by the researchers. In this review, variables under consideration are scrutinized and discussed through presentation of relevant articles focusing on a GCC-ASEAN partnership. The presentation begins with an overview of the GCC as potential target market, followed by a brief discussion of both formal and informal transaction costs in the international marketing scene as variables considered for a successful trading agreement. After which is an analysis of the foreign direct investments (FDI) of the regions concerned so as to assess and somehow predict a successful trade agreement should the key issues and concerns be identified and addressed.

The GCC Financial Market

The Arab world is characterized by five attributes that have allowed it to benefit from the favourable international economic conditions. First, it owns the world's largest deposits of energy. It has 58 per cent of all known raw oil reserves and 27 per cent of all proven natural gas reserves. (IMF Country Report, 2009). Second, the Arab world benefits greatly from international remittances. Ratha, Mohapatra and Silwal (2009) in the World Bank Migration and Development Brief 10, cited that the Arab world as a whole again benefited more than other world regions when international remittances quadrupled in 2000-2008. Third, Arab countries have benefited from the global boom in tourism during 2002-2008. Fourth, Arab countries accumulate a lion's share of total global development assistance (World Bank, 2009). Fifth, Arab countries accumulated substantial foreign assets of more than US$2500 per inhabitant in 2006 (IMF, 2009).

In a study conducted by Zarrouk (2001) entitled " A Survey of Barriers to Trade and Investment in Arab Countries" wherein a total of 230 companies, which represent the manufacturing and service sectors of Egypt, Gaza-West Bank, Jordan, Lebanon, Saudi Arabia, Syria, Tunisia and the UAE, it was revealed that the trading barriers are most intensive in Gaza-West Bank with a mean of 2. 0, followed by Syria (mean = 2. 1), Egypt (mean = 2/41), Tunisia (mean = 2. 43) and Saudi Arabia (mean = 2. 8). Zarrouk (2001) describes the mean score from a scale of 1 (extremely problematic) to 4 (not problematic) (please refer to the table adapted from Zarrouk, 2001).

From the result of the study of Zarrouk (2010) it can be inferred that Saudi Arabia figured as a country, wherein an FTA might prove challenging. As to the areas or indicators of what might these trade barriers be. Zarrouk (2010) identified these barriers. First, his study revealed that:

Saudi has " visa restrictions for business visits"

There exists local agency laws which " allows Saudi nationals only to register for business and to be an agent of a foreign company"

Saudi customs are " biased" on Arab-made products but are more lenient to " Asian, North American, and European products"

On the subject of transaction costs, Zarrouk (2010) business enterprises were interviewed as to whether these were not costly (value of 1) to prohibitive (value of 4). It was found out that " customs duties and other import charges" (mean score of 3. 0) ranked first followed by " domestic taxes" (mean score of 2. 6), customs clearance (mean score of 2. 5), public sector corruption (mean score of 2. 4), inspection/conformity certification (mean score of 2. 2), transshipment regulatory measures (mean score of 2. 1), and business visa restrictions (mean score of 1. 8). Please see table below (adapted from Zarrouk, 2001).

When the companies were interviewed about the most restrictive constraints to trade and investment, the study revealed that a primary obstacle is the " weak legal system that fail to ensure that the terms of business contracts are honored” (Zarrouk, 2001; Abdel-latif, 1992). Second in rank is the restrictive local agency law granting business permits only to nationals. In a similar vein, Newquist (1994) hints in his article for Computer World entitled “ Breaking a Barrier to Trade” that cultural values play a role in trade and investment. For instance, he said that “ ethnocentricity” weakens trade. In a free trade agreement wherein foreign nationals are invited to invest in the region, this factor would have a very negative effect indeed. Third in rank as most restrictive is that foreign nationals are prohibited “ ownership of real estate.” This means that foreign investors have less opportunities of staying longer in Arab countries, thus, the cost of transferring to and fro their home country would be quite expensive. In relation to this, Arab countries also puts “ limits on foreign ownership of equities” thus this would mean a slow expansion and growth of businesses. Sadly, corruption, bureaucracy and bad governance also figures in the trade barriers identified by Zarrouk (2001). Meanwhile, “ less transparent and complex tax systems and para-tariffs” were also included in the list of most restrictive barriers.

The GCC has been engaging in trade agreements with countries other than the ASEAN. For instance, they also have a free trade agreement with the EU, the NAFTA, the WTO, and GAFTA in as much as it enjoys bilateral trade relations with a host of other countries as Japan, South Korea, China, Singapore and its neighboring Arab countries.

Zarrouk (2001) also attempted to interview the business enterprises with regard to the free trade agreements signed by their respective governments.

It was revealed in the study (Zarrouk, 2001) that among the trade barriers to a company’s growth according to the respondent companies are:

There is a lack of clear-cut orientation with regards to free trade agreement benefits given to the business enterprises;

Government agencies do not make enough effort to inform the public about the benefits of the agreements;

Competition from Asian countries is much stronger, offsetting the benefits of the agreements

Implementation problems:

Partner countries do not commit to terms and conditions of the agreements

Articles of some agreements are left to the interpretation of customs officials

Trade agreements do not reduce the numerous administrative procedures, paperwork and red tape

Implementation of certain articles of the agreements is not reciprocal

Transportation between Arab countries is inadequate.

Considering these results of the study of Zarrouk (2001) with specific reference effective free trade barrier which states that “ Competition from Asian countries is much stronger, offsetting the benefits of the agreements” a free trade agreement between the GCC and the ASEAN is highly workable. This is backed up by a shared trading history that have been shared by both regions (Press Trust India, 2010; The Malaysian National News, 2010; Reuters, 2010).

Transaction Costs

In Economics, a transaction cost is " cost associated with exchange of goods or services and incurred in overcoming market imperfections" (BusinessDictionary. com). Also known as frictional costs, these are fees and charges incidental to buying, selling, and trading which includes transportation costs, legal fees, communications charges, and even opportunity costs in taking up time and energy in putting up a business venture.

As cited by Abdel-Latif (1992), transaction costs cover a wide range of transactions from the conceptualization of putting up an investment until the actual running of the business itself.

Generally, transaction costs include:

the costs of obtaining information about market conditions in any given foreign market (the quantities and qualities desired and the prices prevailing for each different quality) and the reciprocal costs for agents in foreign countries;

the costs of information about government regulations and other policies in both foreign and home markets (including exchange rate policy, exchange restrictions, tariff and non-tariff barriers, and health and environmental regulations);

the costs to each potential party of identifying appropriate trading partners in these markets;

the costs of negotiating, writing, and enforcing contracts and resolving disputes between the parties; and

the costs of financing the transaction, which generally involves a long lag between placing an export order and making final payment for it, and of bearing the risks of default throughout the process.

Abdel-Latif (1992) further corroborates that these transactions costs are affected by several factors which includes:

differences in language, culture and taste, laws and dispute resolution procedures, income and information sources, the modus operandi of markets, and the extent and character of competition,

difficulties of enforcing contracts across countries, and hence the higher risks of payment default.

However, these factors are dynamic and changes over time along with the changes in organizational structure, advent of new policies and regulations, use of technology in communications, transportation, and other aspects of the dynamic societal structure whether environmental, socioeconomic, political or cultural. Other factors which may give rise to transaction costs are what is known as " asymmetry of information" which is elemental to any business relationship.

“ For example, at the level of the rules and regulations, countries may want conditions to look different than they really are or may be unwilling to enforce existing laws. Likewise, the agents responsible for implementing the rules may have little incentive to do so and indeed may have the incentive to leave the interpretation of these rules sufficiently ambiguous so as to generate rents for themselves. Even more relevant and important, each potential trading partner has better information about his own characteristics and propensities (appropriate to defining the terms of the contract) than does the other party, inducing adverse self-selection for any given terms.” (Abdel-Latif, 2001)

Theoretically, any contract between trading partners details enough fine points for a working partnership to thrive. However, in reality, the details of these contracts—which includes threshing out possible roadblocks as well as scrutinizing everything takes up a lot of time and discussions, and most often ends in stalemate. Thus, the costs of drawing up a very detailed and comprehensive trading pact whose interpretation is transparent and accurate are quite expensive. Moreover, there is a time lag in having these agreements move to and fro the business partners and, thus, there is a likelihood of it being exposed to risks as moral hazards and resorting to shortcut methods in order to get through a deal.

Transaction costs in the communications and in dispensing information are exposed to a host of other factors like insufficient insurance systems to keep the transactions private in order to protect the enterprise practices, the non-existence of competitive markets who should have been able to provide services such as that in information and enforcement costs for the reason that there already exists a specified role for an intermediary providing the aforementioned services. Thus, the scenario is that there is a monopoly of the services and upon which the government base its trade intervention and other regulations.

Once a business enterprise engages itself in a contract it exposes itself to risks. Hence, after engaging in a contract both parties would naturally protect itself from these purported risks by seeking insurance. Moreover, when the company seeks this insurance it presents itself to an " asymmetry of information" wherein both parties fall into excessive negotiation costs as well as lags in time which further results to attempt a moral hazard and become opportunistic (Abdel-Latif, 1992).

The upside of this is that the degree and magnitude of these problems in transaction costs depends on the salient features of the business in the region, on the regions conducting trade and investment itself, the companies or enterprise involved in the transaction, and even the socio-political and environmental conditions itself. Furthermore, the enterprise itself may just well revive itself and find its own innovative solutions to get over these problems (Abdel-Latif, 1992).

Foreign Direct Investment (FDI)

Foreign direct investment or FDI refers to " any form of investment that earns interest in enterprises which functions outside the domestic territory of the investor" (Graham & Spaulding, 2010). An FDI calls for a business partnership between a parent company and its foreign subsidiary. The presence of multinational companies concretizes a foreign direct investment.

There are two categories of FDIs, inward FDIs and outward FDIs, which depends on the kinds of restrictions the government requires business enterprises to follow. Outward FDIs are " direct investments abroad," which requires tax incentives and/or disincentives, and which the government tries to guard from probable risks of any form (Graham & Spaulding, 2010).

Aside from the classification, a foreign direct investment is motivated by a lucrative market, presence of resources, and efficiency in operating a business in the region (Graham & Spaulding, 2010). In any case, a successful free trade agreement between regions base most of its terms and conditions in these three motives. These three motivations are already present in a partnership with GCC and ASEAN. As it is, both regions are said to be complementing each other in the sense that ASEAN countries have a need for the oil industry of the GCC and the GCC countries have a need for the resources, particularly the agricultural sector, for itself.

With the advent of new technology developments, more and more companies have been establishing foreign direct investments (Spaulding & Graham, 2010). This is partly because communications as well as transportation costs have decidedly become cheaper as compared in the past (Graham & Spaulding, 2010). UNCTAD reports that there is an increase in the yearly FDI flow from an average of $10 billion dollars to $20 billion within a decade (from 1970's to 1980's). This growth further hit the roof from $26. 7 billion in 1990 to $179 billion in 1998. The amount doubled to $208 billion in 1999. At present, FDIs comprise a bulky portion of global businesses.

Satsuya (2009) revealed in his article that among the issues that hinder foreign direct investments, particularly in Malaysia and Thailand, runs parallel with foreign ownership of companies. In the telecommunications sector, distribution and commercial banking, foreign ownership is narrowed to 30 percent. Malaysia limits foreign ownership to industries that have to do with financial industries to 49 percent while foreign banks are only permitted to set up one other branch with a limited number of personnel.

But these limitations are not only true with the ASEAN countries like Malaysia and Thailand. Some of the GCC members, like the Saudi Arabia, also imposes its limitations of foreign ownership of real estate and equities. In fact, this corroborates with the study of Zarrouk (2001) wherein he says that Saudi Arabia ranks among those with severe restrictions on foreign ownership in the country. On the other hand, in Bahrain, foreign distribution services could well put up several distribution branches in the country but they are not allowed to participate in direct commercial sales like wholesale and retail. Though the UAE is more friendly to foreign investors offering 100 percent ownership in free trade zones, such as Abu Dhabi, it limits foreign ownership to 49 percent outside the free trade zones. Thus, foreign industry expansions are still limited. Meanwhile, the telecommunications sector remain off limits to foreign ownership as well as the granting of licenses to any foreign bank to operate as a full-fledged financial institution.

Key Issues and Concerns Identified by Independent Papers

Along the domestic spheres, Sasuya (2009) identified these factors which the government enforces in order to safeguard most of its defunct local commerce, and thereby contributing to the evolution of trade and investment in the region. Some of these measures involve dependence on subsidies, setting up of importation quotas and exacting high taxes on imports. By so doing, while the GCC and ASEAN regions inadvertently protects its industries from trade it also prevents foreign investments from entering the picture (Sasuya, 2009). In the same manner, it is because of these trade defensive measures that there are " deadlocks" on negotiations such as a free trade agreement which generally banks in reducing tariffs on imports. For instance, when Japan and South Korea started negotiating a free trade agreement with Thailand, Malaysia and the Philippines, angst rose from the terms regarding its agricultural tariffs and issues arising from full-ownership of an agricultural company of a foreign national also emerged, especially from the Thai end. According to the Commerce Minister Somkid Jatusripitak, who was also its Deputy Prime Minister, their refusal to bring down tariff on rice imports is due to the fact that 70 percent of the Thais are rice farmers (Satsuya, 2009). In Malaysia, this barrier is much more extensive. With the Malaysian government instigating its Bumiputera development policy, which operates in favor of the ethnic Malay majority who incidentally belong to borderline economy, thereby affecting not only trade but the flow of foreign direct investments. Thus, by refusing to reduce tariffs on rice imports the government is actually protecting its constituents but is, in a way, increasing the transaction costs incurred by this particular deadlock.

In the manufacturing sector, high tariffs also act as trade barriers. In Malaysia for instance, automobile imports have high taxes to protect its local automobile industry, Proton. Even if the Thais do not manufacture any automobiles, the country is sponsoring the industry as part of its industrialization scheme in which they envision becoming an auto manufacturing center. Meanwhile, the textile industry is also shielded in the sense that it imposes 20-30 percent tax on all imports (Satsuya, 2009).

There exists a statistical relationship between trade influx and political climate. According to Bergeijk (1992) a country with good diplomatic relations also increases its chances of getting bilateral business trades as well as drawing in foreign investors. However, the researcher also warns not to put too much emphasis on this variable as it has less contribution than other economic variables. Nevertheless, the fact that it contributes some amount of influence on the way companies conduct their business should not be discarded.

Aside from political and diplomatic relations, a separate study finds that environmental constraints in the form of policies of the region also act as a trade barrier (Kohn, 2003). For instance, if and when a foreign investor should want to import a product which proves to be more polluting than the existing domestic product, the company woul