



*Centre for
International
Economic
Studies*

Policy Discussion Paper

No. 97/13

University of Adelaide • Adelaide • SA 5005 • Australia

**POTENTIAL FOR INVESTMENT LIBERALIZATION
BETWEEN AFTA AND CER**

Bijit Bora

November 1997

CIES POLICY DISCUSSION PAPER 97/13

**POTENTIAL FOR INVESTMENT LIBERALIZATION
BETWEEN AFTA AND CER**

Bijit Bora

School of Economics
Flinders University of South Australia
GPO Box 2100
Adelaide SA
Australia

ph: +61 8 8201 2475
fax: +61 8 8201 5071
bijit.bora@flinders.edu.au

November 1997

This is a revised version of a paper entitled "Potential for Services and Investment Liberalisation" presented to the *AFTA-CER Linkage: The Way Forward* conference in Singapore, September 5-6, 1997 organized jointly by the Asia 2000 Foundation, University of Melbourne Business School, Institute of Policy Studies and Institute of Southeast Asian Studies. I thank my co-authors on the earlier paper, Tony Warren and Christopher Findlay for comments, as well as comments from participants in the workshop. Part of this work has been funded by an Australian Research Council Special Research Initiatives Grant Schemes.

SUMMARY

The political will to establish a link between the ASEAN Free Trade Area and the Australia-New Zealand Closer Economic Relations Agreement has generated a number of issues. This paper looks at the scope for a medium term investment linkage. The paper does not canvas the specific issue of formal investment rules within an AFTA-CER agreement, but examines facilitation and cooperation initiatives that can be undertaken.

Incorporating investment in the AFTA-CER dialogue is interesting since investment is not explicitly in either agreement. AFTA members have proposed an ASEAN Investment Area (AIA), but this concept is still in its infancy. Australian reluctance to include investment in the CER has led not only its exclusion, but also no initiatives to bring it within the agreement, to complete the so-called "missing" link. The AFTA-CER investment question also arises against a backdrop of regional and multilateral investment initiatives such as within APEC and the OECD. This means that any initiative should, at the very least, not be duplicative and complement these regional and multilateral efforts.

The paper puts forth specific and practical proposals to initiate an AFTA-CER dialogue. As a start, the paper proposes including Australia and New Zealand as observers in the meetings for the AIA and attending the ASEAN Heads of Investment Meeting. Such a practical step can then be complemented by specific technical assistance programs such as meeting the obligation of many of ASEAN members to eliminate trade-related investment measures (TRIMs) by the year 2000 to technical training programs on the contents and implications for the OECD Multilateral Agreement on Investment.

The paper also takes into account the diversity of ASEAN's membership. Complex issues such as investment will be difficult for their new members, Vietnam, Myanmar and Laos, hence the need to avoid moving directly to negotiating rules. Again, this is an area where Australia and New Zealand expertise can assist to enhance the investment regimes in ASEAN and facilitate further growth in intra-AFTA-CER investment flows.

POTENTIAL FOR INVESTMENT LIBERALIZATION BETWEEN AFTA AND CER

Bijit Bora

Introduction

The increasing proliferation of regional trade agreements has triggered a corresponding increase in the academic literature. In most instances this literature has focussed on whether or not these agreements are compatible with the multilateral trading system. (Bora and Findlay, 1996) In cases where linkages between agreements are considered, again the focus has been negative. Issues such as a 'hub and spoke' trading system dominate these concerns (Snape, 1996). These issues are also complicated by the fact that the very nature of regional trading agreements themselves has been changing rapidly (Lloyd (1996a). These changes have not been confined to membership, but also in their scope and coverage. In this paper we focus on the task of the volume which is to identify strategies for developing the medium term investment linkage between the ASEAN Free Trade Area (AFTA) and the Australia - New Zealand Closer Economic Relations agreement (CER).

Although our focus is narrowed considerably because of its restriction to issues relating to investment, there are some guiding principles, which should be made explicit at the outset. Despite the fact that both AFTA and CER are conditional MFN agreements, all the countries concerned have expressed their support, either unilaterally or through their APEC commitments, for the multilateral trading system.¹ This fact is central to the discussion below. I am not envisaging, nor am I encouraging a further deepening of preferences amongst members.² Instead, we emphasize measures, which would ensure an enhanced and increased flow of services and investment within the ASEAN-CER region as well as preserving the integrity of the multilateral trading system.

¹ Myanmar, Laos and Vietnam are not members of APEC. Also, we should note the strong point made by Scollay (1996) that although the CER is a preferential agreement Australia and New Zealand have undertaken a significant unilateral program to erode this degree of preferences.

² See the paper by Purnell in this volume, where he explicitly focuses on free trade within AFTA and CER by 2003 to coincide with the phased reduction in tariffs within AFTA.

The format used is to briefly review existing work on investment within AFTA and CER and identify common elements. These are then benchmarked against the task of putting forth recommendations for additional liberalization. Before this, however, we review Australia and New Zealand's experience with FDI. The reason for this is that this is a relatively understudied area. There are numerous studies of FDI into East Asia and the role that it has played as a contributor to economic growth.³ Few, if any have been written on Australia and New Zealand.

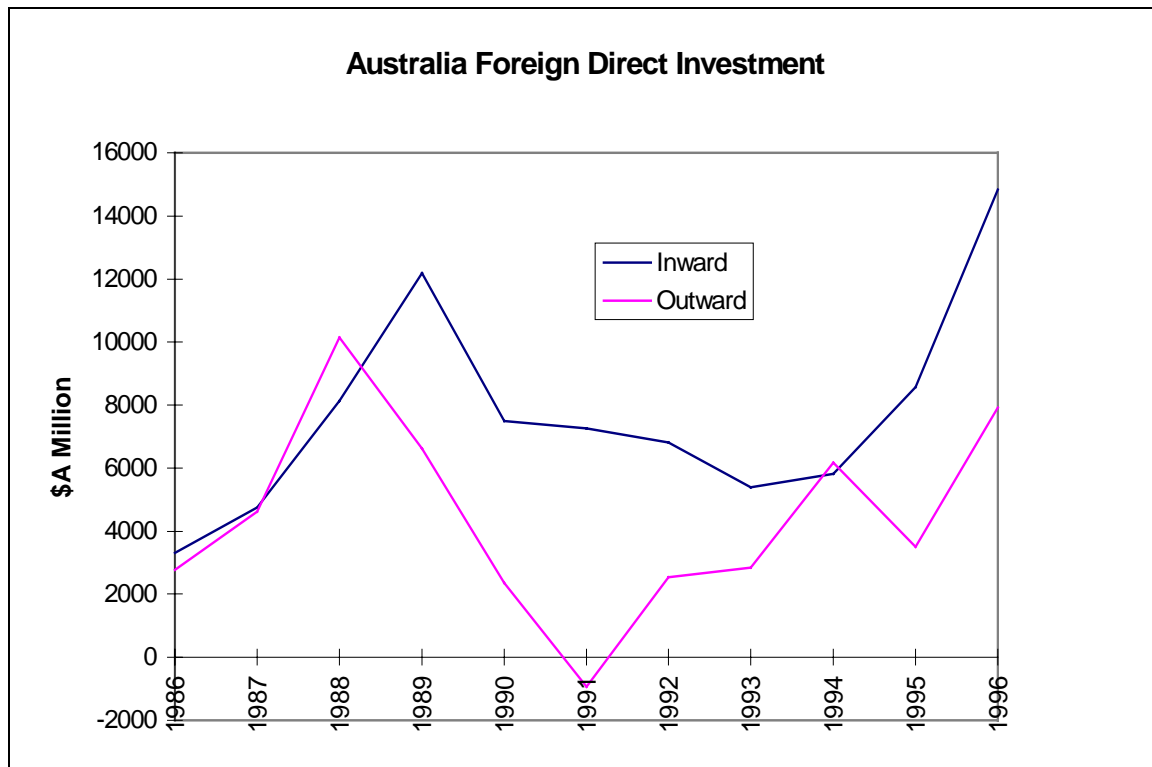
FOREIGN DIRECT INVESTMENT DOWN UNDER

In the early seventies Australia and New Zealand had the highest level of protection of any member of the OECD. Given the small size of both economies, their geographic remoteness from major markets, as well as Britain's decision to join the European Community, it was clear that the only available economic policy was to liberalise. (Anderson, 1995) By the early eighties both Australia and New Zealand were in the midst of an impressive rationalist policy of liberalisation, deregulation and privatisation.

While considerable attention has been focussed on the reduction of tariffs and the privatisation of a number of companies, foreign direct investment has played an important role in the structural change of both economies. Until the rationalisation program both economies adopted selective foreign investment regimes. Foreign investment policy was synonymous with import-substitution policies (Bora, 1995a). Tariffs were used to complement the incentive for foreign investors provided by distance. However, the recent reduction of tariffs has meant that both countries are now competing for investment by developing internationally competitive industries.

³ See Bora (1996a) for further references.

Figure 1



Figures 1 and 2 provide an overview of the experience of both countries with foreign direct investment. Given their small size and abundance of resources they have traditionally been net importers of foreign capital. For the most part FDI inflows and outflows for Australia have followed the global trend, with a strong surge in the late eighties followed by a decline and then a strong recovery. In 1996 FDI inflows into Australia surpassed the AUD\$14 billion mark. This figure represents the highest ever level of foreign inflows and the strength of the growth in the past five years would indicate that this would continue.

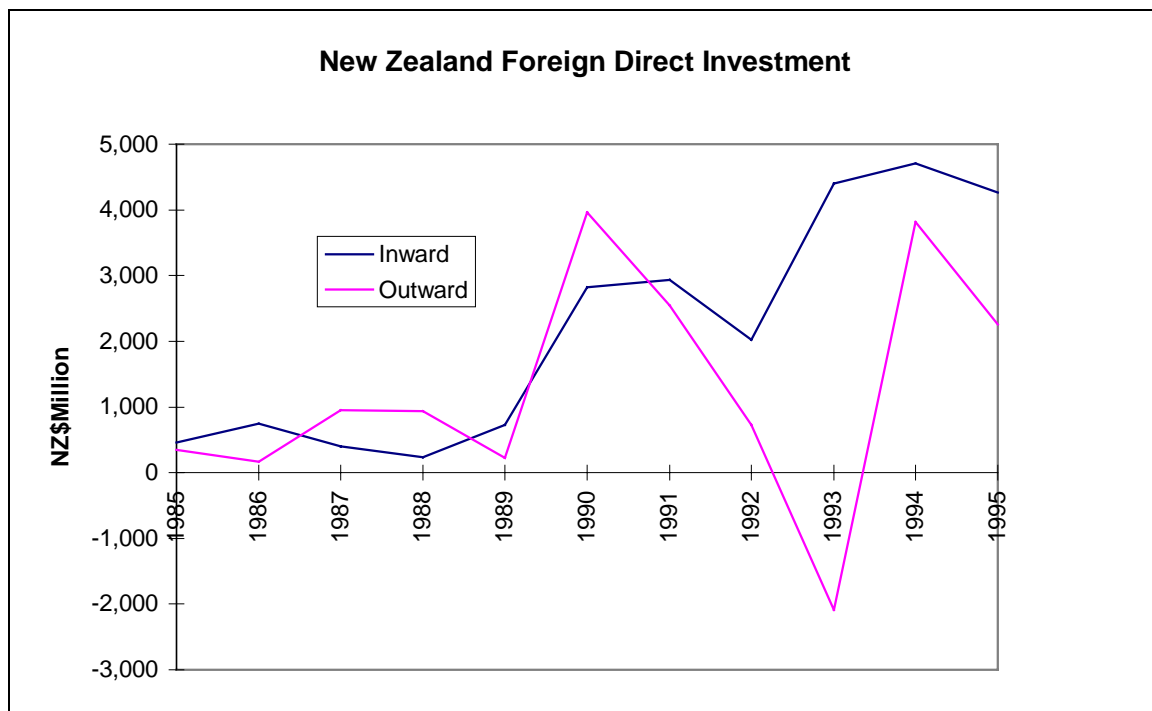
FDI outflows from Australia have also reached their highest ever level prompting an inquiry into the situation by Australia's Industries Commission (1996). However, in 1991 despite the modest level of global flows Australia's outward flows were negative. This figure was eclipsed by the fact that in 1994 Australia's net position was in fact positive with FDI outflows exceeding FDI inflows.⁴

New Zealand's pattern of FDI inflows and outflows have displayed an additional degree of volatility with FDI outflows surpassing inflows a number of times between 1985

⁴ Note that the data for all the Australian figures were sourced from the Australian Bureau of Statistics. The data for New Zealand were taken from the *APEC Guide to Investment Regimes*. Trade data was sourced from the Australian Dept. of Foreign Affairs publication *The APEC Region: Trade and Investment*.

and 1995. New Zealand also experienced a period when its outflows were negative, but this, paradoxically, was in 1993 at a time when global flows of FDI were displaying strong growth. The fact that both countries experienced negative outflows reflects the impact of small developed countries, where large, or “lumpy” projects can have a considerable impact on aggregate flows. FDI inflows are still at very high levels relative to the mid-eighties at NZ\$4,000,000.

Figure 2



Foreign Direct Investment in Australia

Due to its small population base and large endowment of natural resources, Australia has relied heavily on foreign capital and labour for economic growth. The source of both capital and labour has been predominantly from Europe. Figure 3 charts the source of Australia’s stock of inward foreign direct capital by country for 1995. It shows that the two key sources of capital are the United States and the United Kingdom, which when combined account for 50% of the total stock. Japan is the third largest source at 15%. The remaining 35% is divided amongst a large number of countries.

While the extent of this diversification is not unusual for a country the size of Australia, what is important to note is that in 1948 the UK accounted for 95% of all inflows (Bureau of Industry Economics, 1993). The decline of the importance of the UK is a result of

a number of factors, such as the orientation of its investment to other European countries and the rise in investment from U.S. companies in the post- World War II period. As with most countries the increase in Japanese investment was consistent with the general surge in outflows from Japan during that time period.

Figure 3

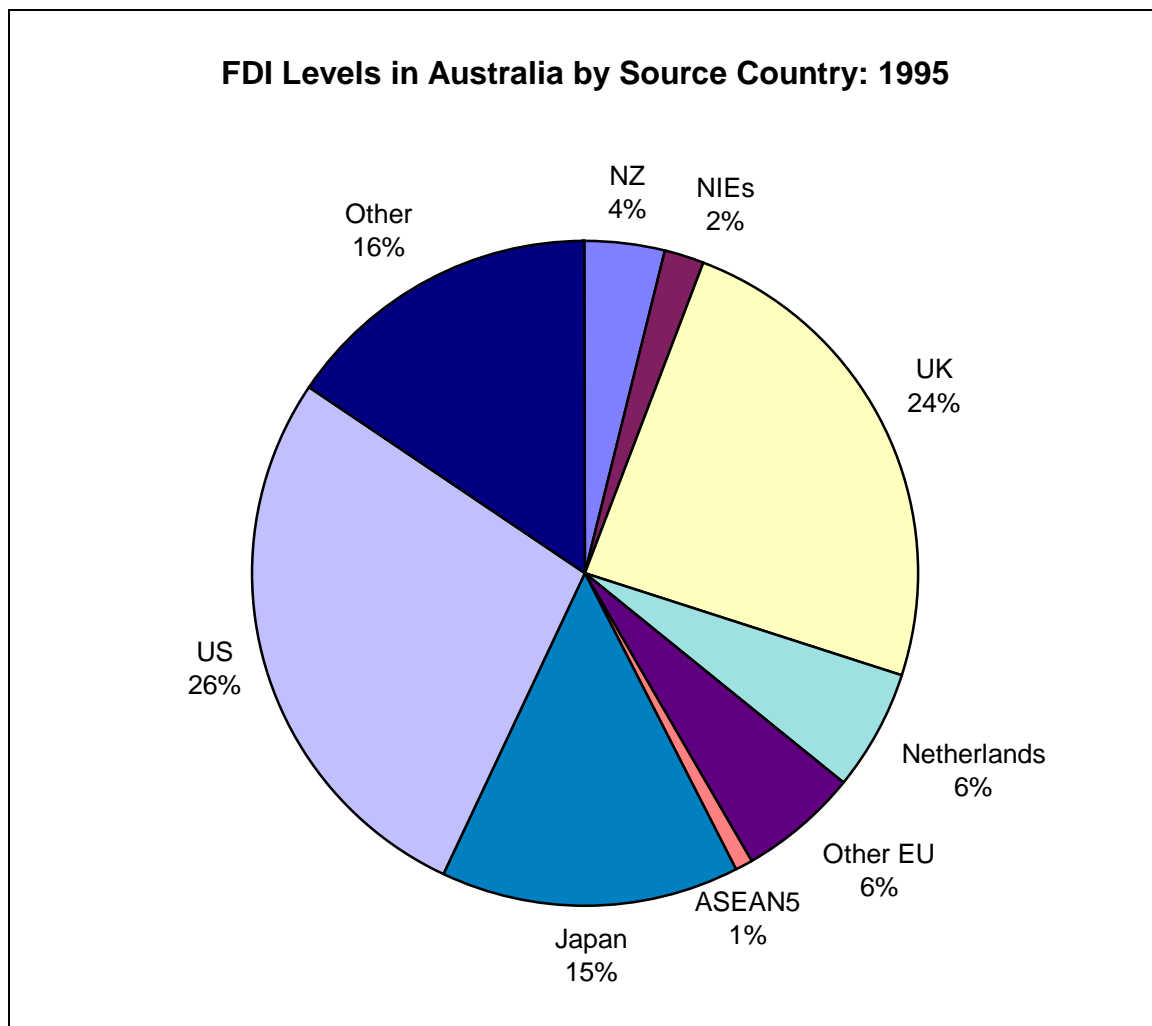
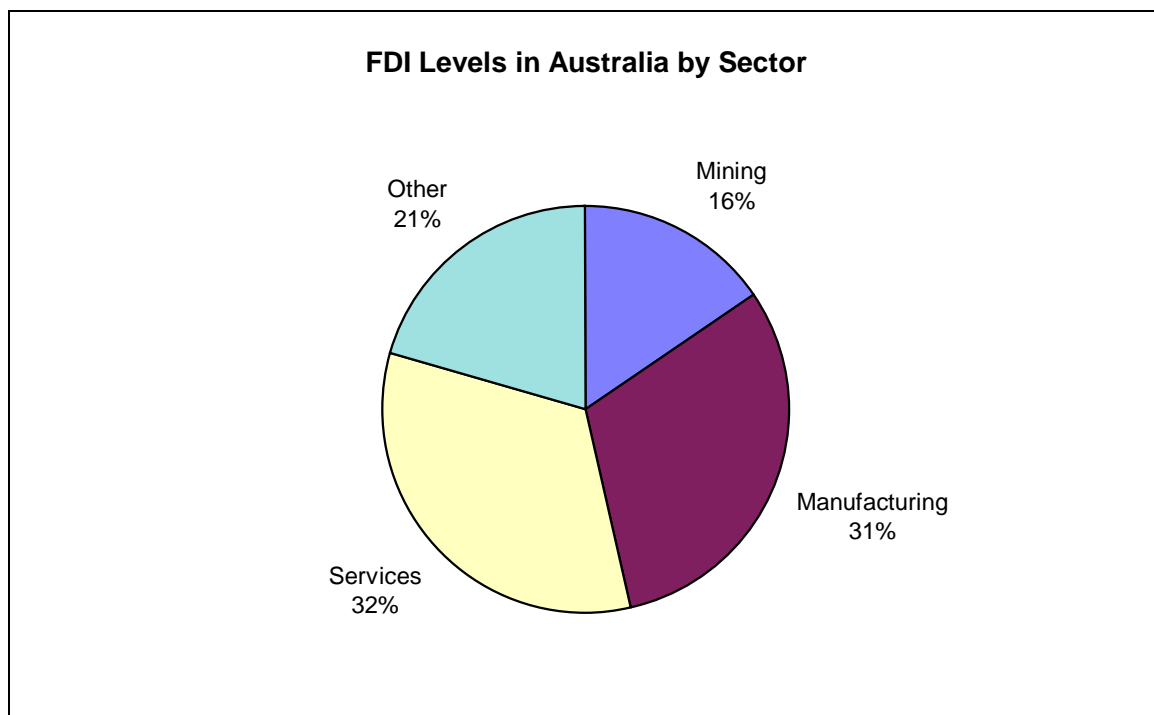


Figure 4 provides a breakdown of the industrial structure of FDI into Australia. It shows that services and manufacturing are equally represented with each sector receiving almost a third of total flows. Again, this is not unusual for a country the size of Australia. However, the significance of the service sector, however, is relatively new. In the late fifties mining and agriculture accounted for only 12 per cent of inflows, services 11 per cent while manufacturing accounted for 77 per cent. Now the service sector has grown rapidly, while the manufacturing sector has declined, which means the service sector will soon become the dominant host for foreign investment.

Within the service sector the key areas are property and finance. In fact one issue which is extremely sensitive is foreign ownership of key real estate areas such as the Sydney Harbour, Gold Coast and Northern Queensland. As Bora (1995b) points out the sequential liberalisation of Australia's foreign investment policies in the early eighties, was interrupted by a tightening of the restrictions related to foreign ownership of real estate.

The bulk of the investments in the manufacturing sector were attracted to Australia by the high tariff rates. Both foreign and domestic firms were shielded from competition by the high levels of protection and also the large distances between Australia and other developed economies. As a result the Australian industrial landscape consisted of small scale inefficient enterprises. Declining rates of protection and the growth of the service sector has lowered the attraction of the sector as a host for foreign investment, thereby forcing it to become more competitive and productive.

Figure 4



The destination of Australian FDI abroad is depicted in Figure 5. The UK is the dominant host for Australian investment with 38% of the outstanding stock in 1995. The second largest host was the United States, which is followed by New Zealand. An interesting feature of Australian outward investment is the importance of PNG. At 4% of the outstanding stock it hosts almost as much Australian foreign direct capital as the EU without the U.K.. Part of the

reason for such a high level of investment is the fact that Australia's relations with PNG have always been close. Not only does Australia provide a substantial amount of aid to PNG, it also played a prominent role in PNG's independence movement in the early seventies. The bulk of the investment is in the mineral's sector and consists of large scale extraction projects.

An interesting aspect of Australian outward investment, given our focus on the ASEAN, is the very low share of investments in East Asia. Figure 5 indicates that the ASEAN hosts only 6% of outward investment, and of the NIEs Hong Kong hosts 1%. This fact is interesting for two reasons. First, the developed countries have had the highest growth in Australian FDI, but the East Asia region has had the most dynamic economic growth rates since the late eighties, yet have been ignored by Australian companies. Second, the orientation of Australia's trade has changed dramatically away from Europe and towards East Asia.

Figure 5

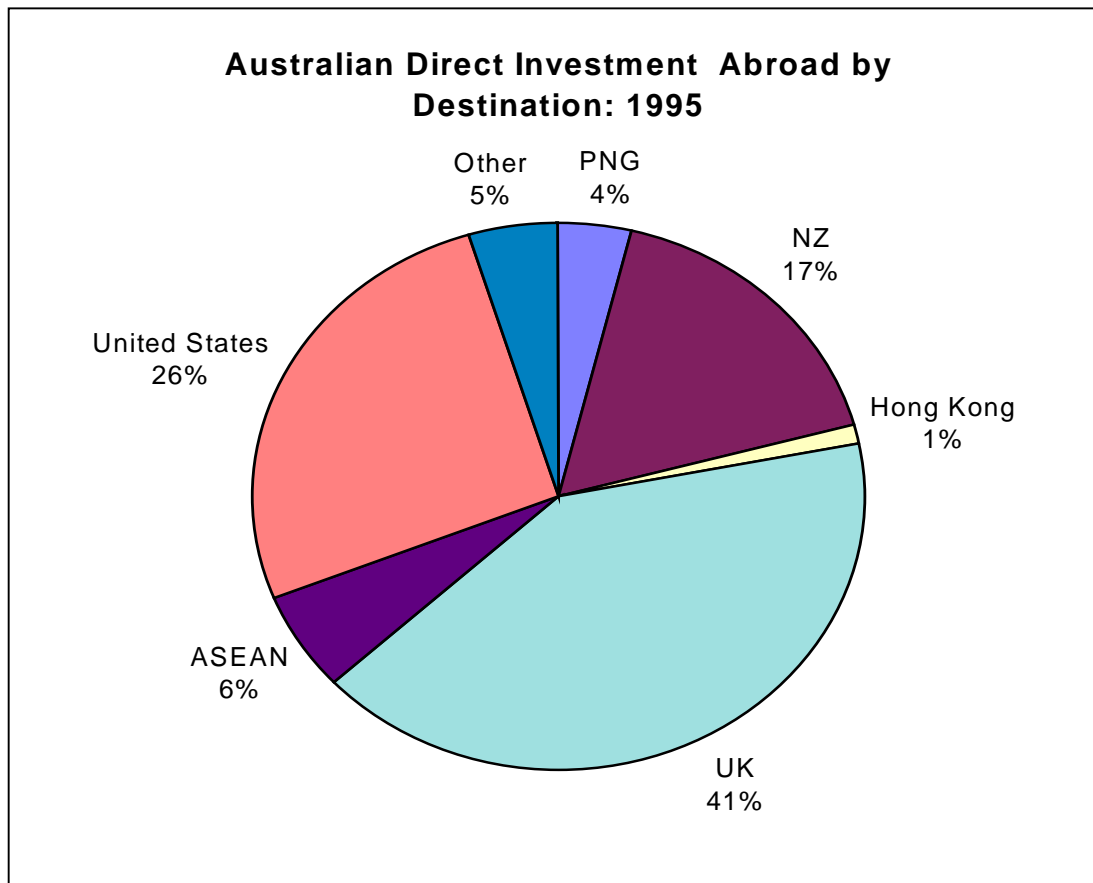


Figure 6

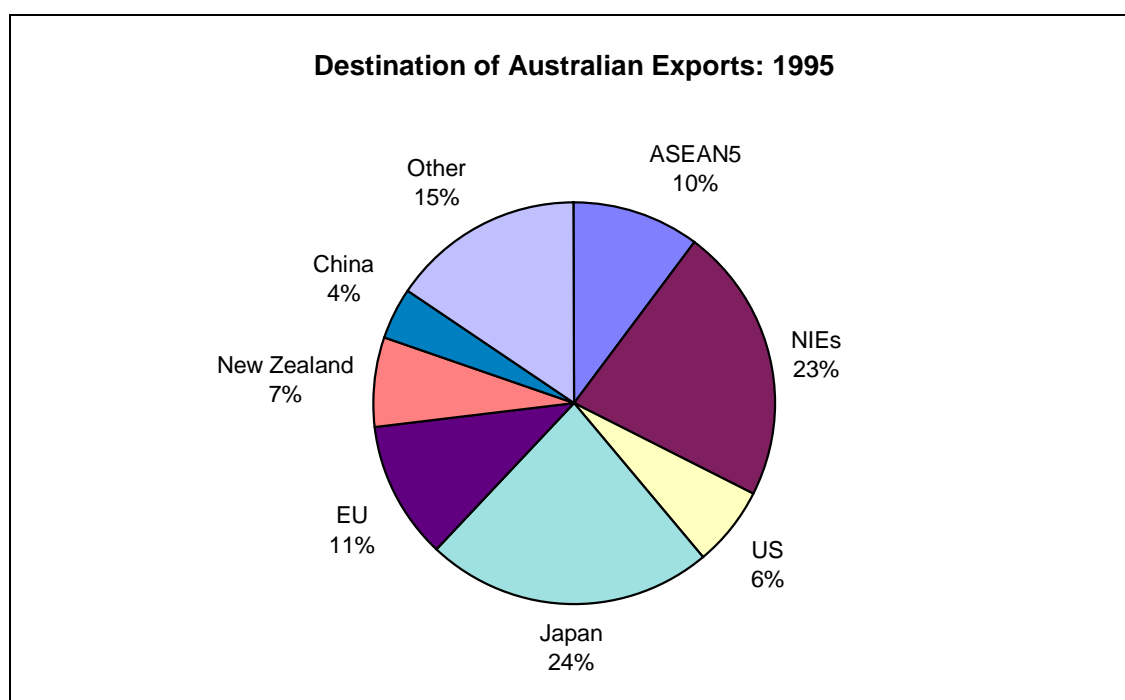


Figure 6 charts the destination of Australia's exports for 1995. It shows the Newly Industrialising Economies of Singapore, Hong Kong, Taiwan and the Republic of Korea account for 23% of exports, which combined with Japan's 24% and the 10% to the ASEAN 5 (ASEAN without Singapore, which is Brunei, Indonesia, Thailand, Malaysia and Philippines) accounts for more than half of the total exports. The non-Asia developed countries on receive 17% of Australia's exports which is entirely consistent with the outward investment figures show in figure 5.

These figures are also more surprising when the fact that the ASEAN and Hong Kong held 46% of the outward stock in 1980. (Bureau of Industry Economics, 1995) Therefore, in fifteen years their share has dropped by almost 40%.

This interesting asymmetry in market access raises questions about the mode of entry. Various theories on foreign direct investment have subscribed to the notion that FDI is a sequential process. It follows exports as a mechanism for enhancing market access. In the Australia's case, however, the puzzle is that the markets in East Asia have opened substantially over the past twenty years, and especially in the past decade, yet Australian investors seem to be "shying" away from the region.

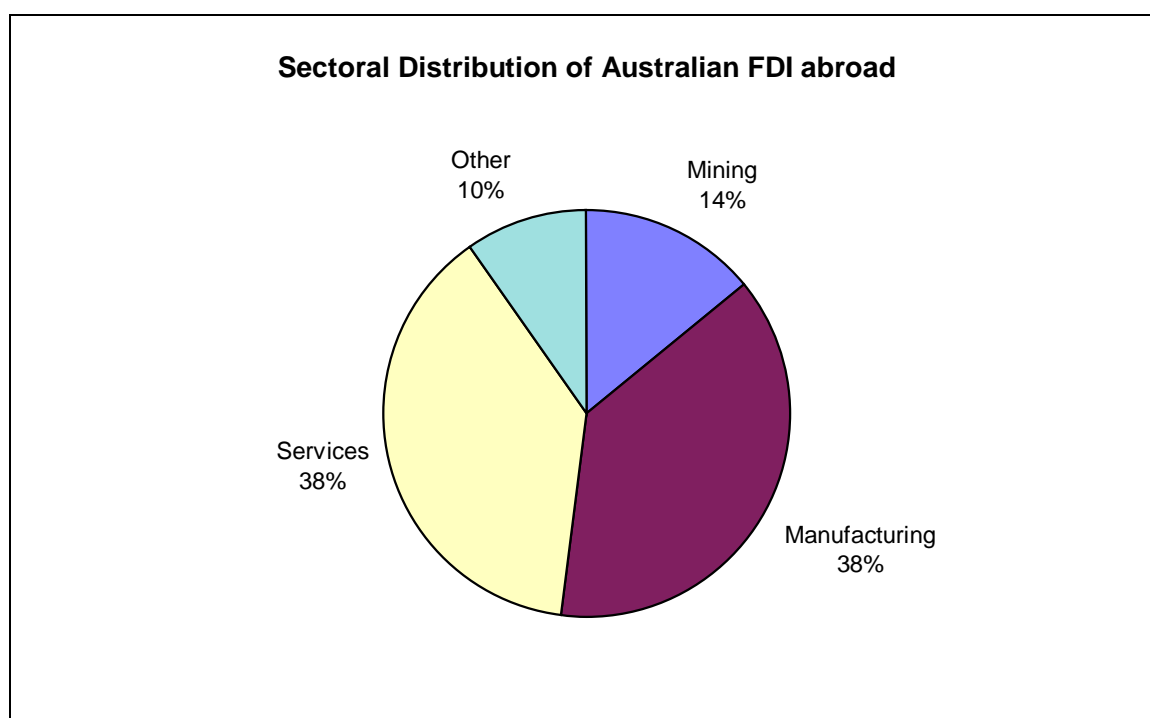
This puzzle is also compounded by the fact that recent surveys on the motives of Australian investors have found that the East Asian region is a high priority for the short to medium term. Why are Australian investors ignoring the region?

Surveys and case studies of Australian business have revealed a tension between profitability and risk associated with East Asia. While the potential for profit is high and opportunities are available, they are outweighed by the risks associated with investing in the region. Another recurring thesis is the fact that the Australian 'business culture' is still intimately tied to the U.K. and the United States - the well known and comfortable markets.

One reason, which requires closer investigation, is the industrial structure of Australia's FDI outflows to East Asia, relative to its factor content of trade. The paucity of data makes it difficult to cross-tabulate the country data with the industry data, but preliminary investigations have found that the decline in the share of FDI going to the ASEAN region was almost entirely in the manufacturing sector (BIE, 1995). In 1981 the ASEAN held 68% of the stock of Australian direct investment abroad in manufacturing. Yet by 1987 that figure had collapsed to under 5% but is now rising steadily. In contrast the stocks of outward FDI in the services sector increased markedly in New Zealand and the U.K., but not in the United States. The increases in the U.S. were in the mining sector.

Therefore, the decline in the share of Australian FDI could simply reflect a mismatch between the factors, which make East Asia a host for FDI and the advantages, possessed by Australian firms when they seek to make investments. For example, a significant portion of the FDI into East Asia was in labour-intensive manufacturing industries. Australian industries are not known for their comparative advantage in these industries, hence have not been active investors. This, however, may change as tariffs continue to decline in Australia, as well as employment.

Figure 7



Figures 8 and 9 document New Zealand's experience with FDI inflow. Paucity of data is also a problem in this case with only highly aggregated data available for flow data. Nevertheless, the picture is quite similar to that of Australia with only a small share of inward investment coming from Asia when Japan is excluded. Australia, the United States and the U.K. are important sources of capital for New Zealand.

From figure 9 it is apparent that the ASEAN is not an important destination for outward investment. Not surprisingly, Australia is an important destination, as are the Cook Islands. The numbers on NZ outward FDI are also complicated by the significant negative figures for outward FDI (see figure 2).

The pattern of New Zealand investment seems to be consistent with their pattern of trade. We discussed above the issue of market access by Australia and its reliance on exports, in the New Zealand case only 7.4% of its exports in 1995 went to the original six ASEAN members. On the other hand Australia is its largest market for exports and one of its largest destinations for foreign investment.

Bora (1996ab) reviews the pattern of foreign investment flows in the Asia Pacific region using stock data. He shows using simply ratios and revealed comparative advantage indexes that intra-ASEAN investment is reasonably important as a destination of capital. In 1992 19.51% of the ASEAN's outward stock was within the region. This figure compares to

only 8.21% in 1980. When considering whether or not as a share of total inward investment this amount is significant he finds that it accounts for only 1.23%.

These numbers when combined with figures 1-9 tell an interesting story. While ASEAN investors are keen to invest within their own region, they are heavily dependent on outside investment. Given the relatively low importance of ASEAN members for Australia and New Zealand the proposals put forth below focus on this very fact.

Figure 8

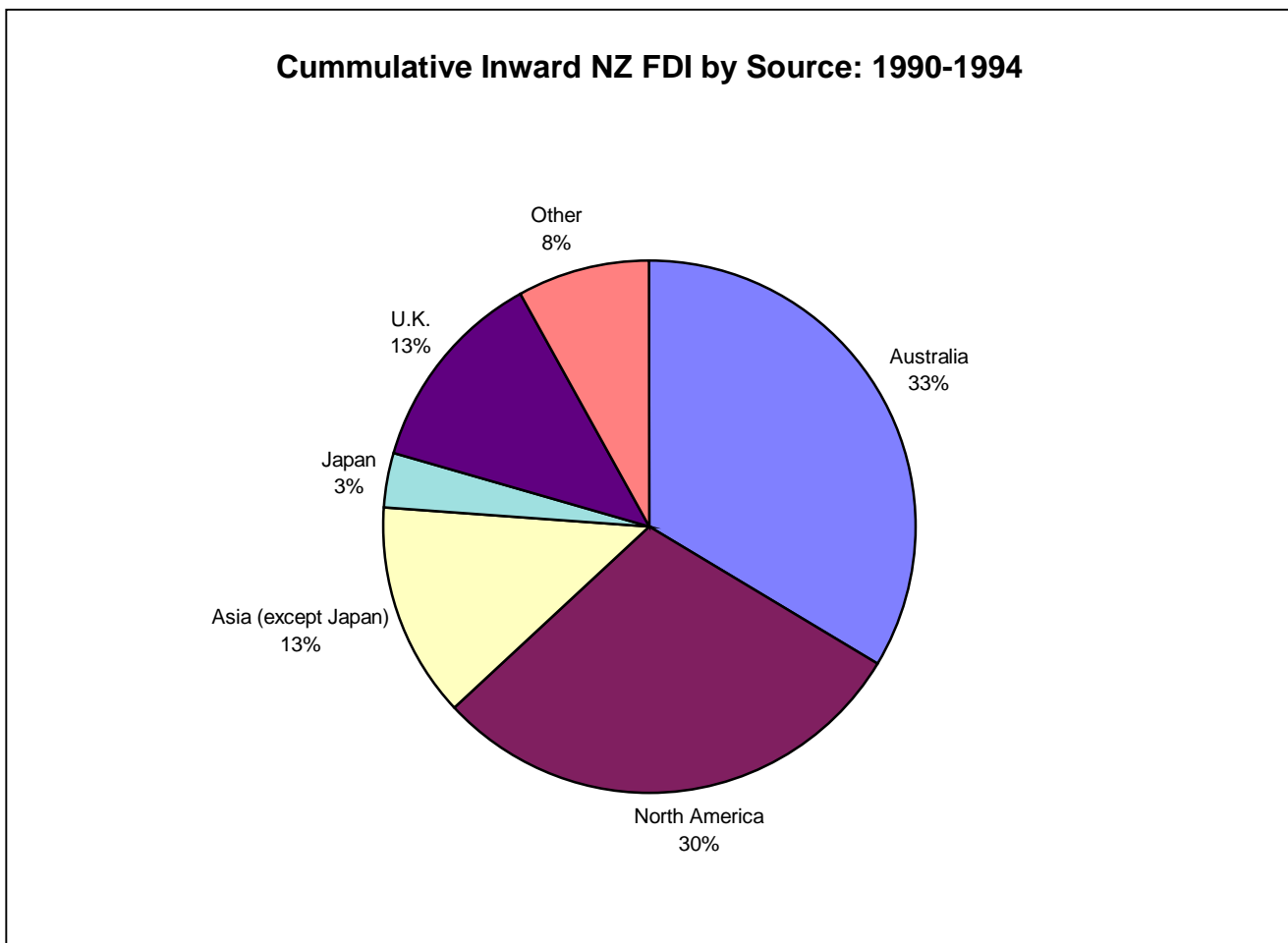
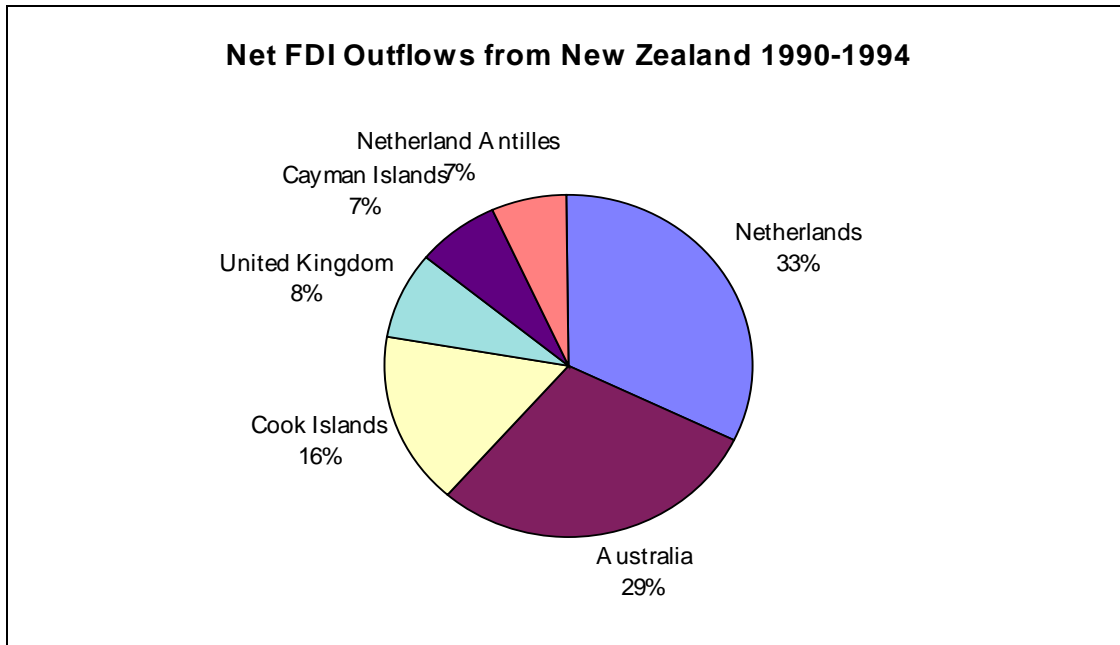


Figure 9



In Australia an increasing area of concern is the role played by the States in the promotion and attraction of foreign investment. The competitive market for foreign capital has resulted in the sub-level governments actively using fiscal incentives to distort the location decisions of firms. While this policy is neither condoned nor used by the Commonwealth government it does raise concerns about the interventionist nature of Australia in the market for foreign capital and the scope for disciplining the use of these policies in any international agreement.

New Zealand also welcomes foreign investment. In 1995 a new set of regulations called the Overseas Investment Regulations were put in place to “define the circumstances in which a foreign entity needs to gain the approval. The welcoming attitude is also tinged with a bit of caution. Investments, either non-land acquisitions or greenfield, are reviewed if they are over NZ\$10 million. Nevertheless, the present government realises that a small developed economy will be heavily dependent on foreign capital and a key factor in attracting that capital is an open and transparent investment regime.

Developments in Investment Policy in AFTA, CER and the Multilateral Trading System

CER

Despite the often quoted 'progressiveness' of the CER agreement due to its abolition of dumping arrangements and the services agreement, one anomaly has always been the noticeable absence of an investment provision. (BIE, 1996c) Some authors such as Lloyd (1995ab,1996b) envisage the evolution of the CER arrangement towards a common market with the free flow of capital, labour, goods and services across the Tasman similar to the European Union. With such a view, not surprisingly, the lack of any meaningful investment provision in the CER would result in the suggestion that it is 'unfinished business'.

Since the clearly stated goal of the CER was to increase the level of integration between Australia and New Zealand why is investment not included? Canada and the United States, two similarly like-minded nations with a similar goal of increasing their economic interdependence did not hesitate to include investment in their Canada-US Trade Agreement.⁵

The answer clearly lies in Canberra instead of Wellington. Australia has also maintained a policy of continuing to screen investments. A number of high profile issues, especially in recent years, have placed pressure on Australia to define its use of the "not contrary to the national interest" clause to screen foreign investments (Bora, 1995). Some of these cases such as the Arnott's biscuit case and more recently the Wonderland Amusement park illustrate that either the Australian public is extremely sensitive to liberalizing foreign investment, or that the Australian Treasury has been too cautious in interpreting the signals. Australia has signed a Friendship and Cooperation Treaty with Japan called The NARA Treaty. Amongst other things it refers to foreign investment, and consequently it has been argued that any preferences granted to New Zealand investors under the CER would then have to be offered to Japanese investors.

Australia's negotiating position in the CER has always been that it was not prepared to grant these preferences to Japan. But that position may instead reflect a particular commitment to maintaining the barriers to capital flows. One view, which "dresses up"

⁵ The investment provision in the Canada-US Trade Agreement was the first provision of its kind to award MFN status to members. In fact, when the North American Free Trade Agreement (NAFTA) was signed between Canada, the United States and Mexico, its investment provision not included an MFN provision, but it also grandfathered provisions in the CUSTA.

Australia's position in CER negotiations, is that Australia has taken the position of being the defender of the MFN principle. But, as Lloyd (1997) points out such a position is untenable. He points out that the provisions of the NARA treaty relate to national treatment rather than to access which is the main issue in the CER discussions. Lloyd goes on to argue that a bilateral liberalization of capital flows “would breach no binding multilateral rules”. He suggests that if a bilateral on investment is reached, then it could be treated by not raising barriers to third countries, and indeed accompanies the bilateral agreement with a commitment to liberalize with respect to third countries as well. Lloyd further suggests that arrangements could be made to include investment in CER in a variety of ways, such as a separate agreement, clauses within the treaty or simply administratively by amending the regulatory practices. He prefers explicit coverage of this item in the treaty.

The Asia Pacific region has long been recognized as an example of the significant role played by foreign investment in sustaining economic growth (World Bank, 1995). Many authors such as Bora (1996a) and PECC (1995a) have highlighted the role played by investment liberalization and the change in attitude of East Asian governments towards foreign investors. Bora and Pangestu (1995) provides an overview of investment liberalization in APEC as well as a specific case study of Indonesia.

Substantial impediments to investment still remain in the region (PECC, 1995b), given the generally positive experience of most East Asian countries, including those within the ASEAN, there has been a trend to further enhancing the foreign investment climate in the region. These initiatives have been both in the context of liberalization, as well as facilitation measures. But, as pointed out in Bora and Pangestu (1995) most of these initiatives have been unilateral as opposed to within formal sub-regional groupings such as the ASEAN, or informal groupings such as sub-regional economic zones.

ASEAN, as a group however, has not been silent on the issue of investment. ASEAN's members began to look at investment issues, within the context of AFTA, at the 1995 Bangkok Summit Declaration in 1995. There the leaders decided "to establish an ASEAN Investment Region which will enhance ASEAN attractiveness and competitiveness for promoting direct investments". The details of the region were not spelt out, but left to the Heads of Investment Agencies within the ASEAN. The Bangkok Declaration of 1995 states that:

ASEAN shall work towards establishing an ASEAN investment region, which will help enhance the area's attractiveness and competitiveness for

promoting direct investment. The promotion of direct investment into and amongst ASEAN Member Countries will help in the development and growth of ASEAN economies. In this regard, ASEAN shall implement among other investment measures, an ASEAN Plan of action on Cooperation and Promotion of Foreign Direct Investment and Intra-ASEAN investment.

Although not specifically stated, the above provision in the Declaration has now come to be known as a proposal for an ASEAN Investment Area (AIA). As part of the process of implementing this objective an ASEAN Heads of Investment Meeting (AHIA) has been established. The first meeting was in Bangkok in 1995. Meetings have been scheduled for each year with the latest meeting just held in Manila in July 1997.

The thrust of the work is contained in the ASEAN Plan of Action on Cooperation and Promotion of Foreign Direct Investment and intra-ASEAN Investment. The initiatives can be summarized as follows:

- Cooperation programs for the promotion of FDI and Intra-ASEAN investment;
- Consultation and exchange of information and experience among ASEAN investment agencies on a regular basis;
- Creation of an ASEAN Investment Unit within the ASEAN Secretariat
- Joint-training program for ASEAN investment officials
- Simplification of investment procedures and enhancement of transparency of investment policies
- Other measures to promote greater intra-ASEAN investment by facilitating effective exploitation of the region's comparative and complementary locational advantages such as in the various sub-regional growth areas.

While this program differs from the CER in that it is a concerted and cooperative effort it still falls well short of the type of investment provision contained in the North American Free Trade Agreement (NAFTA) or the Canada-US Trade Agreement (CUSTA). Those agreements are notable because

- national treatment and right of establishment are enshrined to give investors preferential access
- they include a dispute settlement process that allows for state-state and investor-state disputes.

It is interesting to note, however, that the AHIA has yet to explicitly rule out discussions on granting preferential treatment to ASEAN investors. This fact is disturbing because it means that there is still scope for increasing intra-ASEAN investment by using a preferential investment agreement. This strategy, although not in contravention of any GATT articles, runs counter to the ASEAN claim of 'open regionalism'.

International Developments

Although investment was part of the original proposal for an International Trade Organization in 1947 multilateral rules on investment have yet to be established. Recent developments, however, such as investment provisions in regional agreements are paving the way towards the possibility of such rules in the future. The probability of such an outcome was also further enhanced by the Singapore Declaration of the World Trade Organization to establish a Committee on Investment. What are these developments and how would they impact on both AFTA and CER and the link between them?

OECD

The work in the OECD is probably the most relevant since, aside from NAFTA, it is the most concrete effort to develop plurilateral rules on investment. The initiative to sign the *Multilateral Agreement on Investment* was taken in 1995. The basic framework for the agreement has now been completed and the formal negotiations for exceptions are currently taking place. A final completion date is anticipated to be just prior to the 1998 OECD Ministerial early next year.

There are differing views on the contribution of the MAI to the global trading system. On the one hand expanding the number of countries that are signatories to an instrument with "high standards" is laudable, nevertheless, it is still a discriminatory agreement. As such, fears that are associated with discriminatory trade agreements are still relevant for discriminatory investment agreements. Bora (1997)

OECD members have to some extent acknowledged these concerns by holding a number of information seminars for non-members. Indeed, some claims are that up to 40 non-OECD members maybe interested in acceding to the MAI when it is completed. The geographic and economic composition of these non-members is of direct importance to the ASEAN since New Zealand and Australia would more than likely sign the agreement.

APEC

APEC's Bogor Declaration has the ambition of creating free and open trade investment in the APEC region. Unfortunately, this declaration seems to be lacking a focus on investment. Very little attention has been focussed on the definition of free investment. Bora and Graham (1997) take the view that free investment means an unconditional application of national treatment with clear guidelines for safeguard clauses.

Given the political role of a middle power played by Australia and New Zealand within APEC, there is scope for them along with the APEC-ASEAN members to encourage APEC's liberalization process. This initiative is particularly relevant given the current strong emphasis on APEC's facilitation agenda. Bora and Graham (1997) stress that APEC members can benefit by moving beyond APEC's *Guide to Investment Regimes* and annual business symposium to a clear and precise schedule of implementing national treatment. Therefore, within APEC there is a clear role for a concerted and cooperative AFTA-CER linkage on this process. We shall develop this point a little further below.

World Trade Organization

The inaugural Ministerial meeting for the World Trade Organization held in Singapore in December 1996. Among the many achievements was a decision to establish a Working Group to examine the relationship between trade and investment. While the progress of this group will be slow, there is a clear recognition that investment issues cannot be ignored.

It should be noted that the Uruguay Round agreement does contain provisions which affect investment policy. Perhaps the most significant of these is the General Agreement on Services (GATs). It contains a provision, which allows for the delivery of services in the form of a commercial presence. Accordingly, national treatment applies between foreign and national firms. In this context, other elements of the Uruguay Round such as trade-related-investment-measures (TRIMs) restrain the use of certain types of content measures and trade-related-intellectual property (TRIPs) provisions offer protection to the property of other WTO members. While these advances should be applauded it should be recognized that they do not constitute a full set of principles as envisioned by Bora and Graham (1996). National treatment is not offered to foreign investment and neither is right of establishment. This too creates the scope for AFTA-CER linkage to contribute to an agenda beyond the WTO.

Recommendations on Investment Liberalization and Cooperation

The overview in the previous sections on work on investment has raised a number of general investment issues. In this section we shall develop these issues further and make recommendations to strengthen the AFTA-CER the linkage in the medium term with a view to increasing investment liberalization.

Research on AFTA-CER Investment Flows

The starting point for any set of recommendations has to be the provision of reliable and accurate data. Unfortunately in the area of investment the data is extremely poor. What little data is available makes it difficult to ascertain the precise investment relationship between AFTA and CER members. There are numerous studies of FDI in East Asia and more limited studies on FDI in Australia. However, there is still no reliable and detailed study of the AFTA-CER investment relationship.⁶ This fact is further complicated by the inclusion of Vietnam, Myanmar and Laos, for which almost no data is available.

In strong contrast to investment data, trade data by commodity, origin and destination is readily available. Furthermore, the successful launch of the APEC Tariff Database on the Internet now allows researchers to access tariff rates for these commodities by APEC member. In the area of investment, cardinal comparisons of investment regimes are simply not possible.

We suggest a detailed and significant research study of the AFTA-CER investment linkages be completed to identify investment issues, which would merit further research. Included in this study would be a detailed comparison of each of the investment regimes of AFTA and CER members, along the lines of the two studies by the Pacific Economic Cooperation Council (PECC, 1995ab).

Intensifying existing areas of investment work.

We have highlighted some resistance in Australia to examining avenues for investment liberalization, which contrasted with the ASEAN work program on investment cooperation.

⁶ The forthcoming *World Investment Report* does contain a section on the Australia and ASEAN FDI and trade relationship. It highlights an interesting issue where the importance of ASEAN as a destination for Australian FDI has declined markedly over the last ten years, yet at the same time the ASEAN as a destination for Australian exports has increased. The report goes on to suggest that this sequencing is inconsistent with the orthodox view that trade precedes FDI.

An obvious area for directly strengthening the linkage is to include Australia and New Zealand in the ASEAN work. This could be done in stages. In the first instance, both Australia and New Zealand could be given observer status at the next AHIA meeting in Malaysia. From there, work could progress, if feasible to a possible AFTA-CER Investment Area. Australia and New Zealand could be given special observer status to send delegations to the ASEAN Heads of Investment Meetings.

Incorporating, Myanmar Laos and Vietnam into the APEC work on Investment.

The expansion of ASEAN to include Vietnam and then Laos and Myanmar means that ASEAN now includes non-APEC members. Given APEC's clear and unequivocal commitment to MFN and its overemphasis in the investment area on facilitation and cooperation there is scope for the CER members to assist these countries better understand APEC's work. There is also additional scope to take advantage of the MFN nature of APEC and duplicate APEC's work in Myanmar, Laos and Vietnam.

Australia and New Zealand through their Aid agencies could develop a training program to include Myanmar and Laos in the APEC Investment program. This work could progress in stages, with the first step being education seminars on APEC and the drafting an overview of both the Myanmar and Laos investment regimes using the APEC Guide to Investment Regimes as a template. Myanmar, Laos and Vietnam could be invited to endorse the APEC Non-Binding Investment Principles and Australia and New Zealand could investigate avenues to encourage such an outcome.

Investment and the WTO

The revitalization of the multilateral trading system by the successful conclusion of the Uruguay Round of negotiations and the establishment of the World Trade Organization has been given further impetus by the successful inaugural meeting of the WTO Trade Ministers in Singapore. AFTA and CER members could discuss formally the issue of investment rules and investigate common areas of interest vis a vis the WTO work program. This does not mean that there should be a common or harmonized front, but where practicable AFTA and CER members initiate steps to ensure the full inclusion of investment in the WTO.

On a more practical level there is considerable scope for AFTA-CER cooperation in implementing the TRIMs agreement. Indonesia, Malaysia, Philippines and Thailand have notified the WTO that they have measures, which contravene Article II of the TRIMs

agreement. Furthermore, all have notified the automotive sector as being affected by these measures.

According to Article V of the TRIMs agreement all such measures which have been notified will have to be eliminated by the year 2000. At this point such an outcome looks unlikely given the sensitivity of the industry to domestic concerns. There is a provision for an extension of the transition period with in the agreement. A joint AFTA-CER project could be established to assist the ASEAN countries to meet their TRIMs obligations. This assistance could in the form of technical cooperation in designing WTO consistent policies to continue the development of this important industry.

The OECD MAI

Notwithstanding the many negative aspects of the MAI, there are also many positive aspects, which should be considered in an AFTA-CER linkage. An extreme view, assuming an endorsement by both Australia and New Zealand of the agreement, would be to encourage an accession by AFTA members to the MAI. Such an option may not be achieving rapidly given the fact that none of the AFTA members were involved in the negotiations and the differing investment regimes across all members would make it unlikely that AFTA as a group could endorse the MAI. Nevertheless, AFTA and CER members could assess the MAI and identify areas for mutual cooperation. In particular, the basic architecture of the MAI could be retained as a basis for those discussions.

Conclusions

The deepening economic integration of the AFTA and CER economies raises the issue of institutional integration. However, as noted in a number of other studies the precise form and degree of institutional integration is an outcome that is generated by individual countries in the process. In this paper we have examined ways by which the evolution towards a formal institutional arrangement between AFTA and CER members can be encouraged to be both deepened and broadened. Its main focus has been on the second aspect, to broaden the process to encourage both investment and services.

We have made it clear at the outset that we have a strong commitment to the multilateral trading system, hence have not envisaged a process which would create a discriminatory AFTA-CER agreement. Instead we have focussed the recommendations and issues on non-discriminatory aspects of the evolutionary process such as facilitation and

cooperation.

Most of the recommendations contained in this paper emphasize the facilitation and cooperation track of economic integration. In particular, using the work at the multilateral level as a benchmark highlights useful activities that AFTA and CER members can undertake such as assisting to bring investment rules into the WTO and intensifying the work in services.

The paper avoided specific recommendations on developing AFTA-CER rules at this stage given the infancy of these discussions in AFTA and the persistence of the Australians not to include it in the CER context. At this stage, however, given the fact that the MAI negotiations will conclude soon and the APEC work program on investment seems to be gaining some focus AFTA-CER rules could prove to be divisive instead of productive.

References

- Anderson, K. (1995) "Australia's Changing Trade Pattern", in R. Pomfret (ed.), *Australia's Trade Policies*, Melbourne, Oxford University Press.
- ASEAN Framework Agreement on Services*, ASEAN Secretariat Homepage, http://www.asean.or.id/economic/eco_srv.htm
- Asia Pacific Economic Cooperation (1995), *Survey of Impediments to Trade and Investment in the APEC Region*, Singapore, APEC Secretariat.
- Bora, B. (1995b), "Globalization and Australian Foreign Investment Policy", in Economic Planning and Advisory Council, *Globalization and its Implications for Australia*, Canberra, Australian Government Publishing Service.
- Bora, B. (1995a) "International Factor Flows", in R. Pomfret (ed.), *Australia's Trade Policies*, Melbourne, Oxford University Press.
- Bora, B. (1996a), "Foreign Direct Investment" in Bora and Findlay (ed.).
- Bora, B. (1996b) "Trade and Investment Developments in APEC: 1980-1993", in P. Lloyd and L. Williams (ed.), *Trade and Migration in the APEC Region*, Melbourne, Oxford University Press.
- Bora, B. (1997), "Regional Investment Agreements and the Multilateral Trading System", Mimeo, Flinders University of South Australia.
- Bora and Findlay (1996), *Regional Integration and the Asia Pacific*, Melbourne, Oxford University Press.
- Bureau of Industry Economics, 1995 *Australian Direct Investment Abroad: A Statistical Overview*, Canberra, Australian Government Publishing Service.
- Bureau of Industry Economics, 1993, *Multinationals and Governments: Issues and Implications for Australia*, Canberra, Australian Government Publishing Service.
- Bureau of Industry Economics (1995), *Impact of the CER Trade Agreement*, Canberra, Australian Government Publishing Service.
- Industries Commission (1996), *Implications for Australia from Firms Locating Offshore*, Report No. 53, Canberra, Australian Government Publishing Service.
- Lloyd P. (1995a), "Should AFTA and CER Link?" in Tan, J.L.H (ed.) *AFTA in the Changing International Economy*, Institute of South East Asian Studies, Singapore.
- Lloyd P. (1995b), "The Future of Trans-Tasman Closer Economic Relations", *Agenda*, 2 No. 3, 267-280.
- Lloyd, P. (1996a), "The Changing Nature of Regional Trading Agreements", in Bora and Findlay (ed).

Lloyd, P. (1996b), "The CER: An Assessment", paper presented to the First Annual Conference on International Trade Education and Research, U. of Melbourne, December 1996.

Pacific Economic Cooperation Council (1995a), *Milestones in Liberalization: A Map of market opening measures in APEC Economies*, Singapore, Pacific Economic Cooperation Council.

Pacific Economic Cooperation Council (1995b), *Survey of Impediments to Trade and Investment in the APEC Region*, Singapore, Pacific Economic Cooperation Council.

Scollay, R. (1996), "Australia-New Zealand Closer Economic Relations Agreement" in Bora and Findlay (1996).

Snape, R. (1996), "Which Regional Trade Agreement", in Bora and Findlay (1996).