

18/04/1998

Intra-Asean trade could solve regional woes

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THE proposal to increase intra-Asean trade using regional currencies to settle regional transactions has gained increasing support among Asean member countries, Thailand and the Philippines in particular. The objective is to economise the use of hard currencies, especially the US dollar, which are currently in acute shortage.

The relevant authorities in Asean, the central banks and Finance and Trade Ministry officials are now working out the guidelines and mechanisms to implement this initiative. In fact it was reported that Thailand and Malaysia are due to start using the baht and ringgit in bilateral trade within the next three months starting with a shipment of palm oil from Malaysia.

The proposal certainly needs serious analysis and assessment on its feasibility, benefits and advantages to participating countries not only in economising the use of the greenback but also in making it a sustainable feature in the region's trade structure.

There are two elements in the proposal: To increase intra-Asean trade per se and to increase the use of regional currencies in settling regional trade transactions.

Increasing intra-Asean trade per se and doing so at any cost is not appropriate. It would only serve the interest of participating countries if the net effect is trade-creating.

'Trade-creating' means the shifting of expenditure from more expensive domestic and/or non-Asean products to cheaper sources within the region. This would lead to a more optimal trade structure and would result in improved welfare of the participating countries.

In the above context, Prime Minister Datuk Seri Dr Mahathir Mohamad and International Trade and Industry Minister Datuk Seri Rafidah Aziz had rightly pointed out that "... in products where the region is competitive, they should be traded more within the region. In doing so the participating countries would reap substantial benefits as well as economies in the use of foreign exchange".

Here again we have to be sure as to what is meant by "competitiveness" of a product. In the present context, Asean products have gained remarkably in terms of competitiveness due to the sharp depreciation of regional currencies vis-a-vis the currencies of other major trading partners.

Nevertheless, increased export competitiveness on the basis of the sharp devaluation of regional currencies alone, without a sustainable improvement in productivity and efficiency, could not be relied upon in the medium- and long-term. In a period of high exchange rate volatility, near-to-full capacity utilisation within the regional economies, and high import contents of the region's manufacturing sector, export competitiveness based on devalued currencies may not be sustainable.

Most intra-Asean trade constitutes re-exports. Very little of the trade is "pure" in the sense that retained intra-Asean imports are small. Efforts to increase genuine intra-Asean trade through the Asean Free Trade Area (Afta) process has not produced significant results. This fact will have a strong influence on the use of regional currencies as a medium for regional trade settlement.

One glaring shortcoming of the Afta programme has been the temporary exclusion of unprocessed agricultural products from the Common Effective

Preferential Tariffs (CEPT) list. Despite the increasing liberalisation of intra-Asean trade in manufactures, regional trade in agricultural products is still subject to heavy protection particularly through the imposition of quotas and licensing.

Under these circumstances, it is not surprising that despite the availability of a large exportable surplus of commodities such as rice, chicken, tapioca, maize, sugar, edible oils, rubber, tropical fruits, vegetables and fish, a number of Asean countries are now facing an acute shortage of these commodities with exorbitant price increases.

Liberalising trade in these products would offer substantial relief to countries facing increased prices and deficit supply of basic commodities. In this sense, the current economic problem could be a blessing in disguise as it instils a sense of urgency to include those commodities in the CEPT list and hence solve the longstanding sensitive issues that have impeded expansion of Afta/CEPT.

A word of caution is in order. Increasing intra-Asean trade should not be at the expense of the region's extra-Asean trade particularly on the export side. Export to non-Asean countries should not be diverted and reduced just to cater for regional demand. This would result in loss of foreign exchange particularly in the case of primary commodities which are now enjoying sharp increases in prices.

Let us now turn to the second element of the proposal: Increasing the use of regional currencies to finance trade. How much scope is there for regional trade that could be financed by regional currencies? What are the necessary guidelines and mechanisms that need to be in place?

As explained earlier, a large proportion of intra-Asean trade is entrepot trade. Products are exported to, and imported from non-Asean economies through Singapore. For this category of trade, the use of regional currencies may not be acceptable to non-Asean partners. It is only for genuine intra-Asean trade that the use of regional currencies may be feasible.

If about 75 per cent of the US\$151.9 billion intra-Asean trade in 1996 constituted entrepot trade then genuine regional trade would be about US\$35-40 billion. This is the maximum value of intra-Asean trade that can be financed by regional currencies. If trade in commodities is to be liberalised then the potential for increasing intra-Asean trade and the use of regional currencies can be enhanced.

With regard to the mechanism, the official suggestion is to adopt the Bilateral Payment Arrangement as practised by Malaysia in her trade with several countries in the South. To begin with, the adoption of the BPA would be on a voluntary basis with a view to evolving this facility into a regional/multilateral arrangement.

There are several variants of the BPAs practised by Malaysia but the most popular is the ALLADA model under which each central bank pays its exporters in the domestic currency and settles on a periodic basis (not exceeding 90 days) the net difference with the other central bank in US dollars.

The basic features of this model include:

- * Bank Negara and the counter-party central bank establishing credit lines in US dollars;
- * The two central banks designating a number of banks for the purpose of issuing and negotiating Letters of Credit (LC);
- * Trade is carried out through the existing financial or banking system;
- * Settlement and payment for imports and exports are made by the designated banks in domestic currency through the central bank; and
- * The central banks will settle among themselves the net amount due to each other in US dollars at the end of the period.

Based on the Malaysia-Thailand trade balance, the value of Malaysia's trade surplus ranged from RM0.3 billion in 1990 to RM0.7 billion in 1995. That is the amount that needs to be settled between the two central banks. In US dollar terms, this is only a meagre sum compared with the situation where the entire bilateral transaction is financed with the greenback.

To ensure the smooth implementation of the arrangement, several guidelines and conditions need to be put in place.

The first relates to the setting of prices of the traded commodities. The price should closely correspond to the world market price. Otherwise there will be no incentive to trade regionally and/or it may result in the purchase of the commodities not for regional use but for re-export to third non-Asean countries.

Second, it must conform to the World Trade Organisation ruling and more importantly the Afta process. Efforts must also be made to ensure that the BPAs would ultimately be phased into the Afta process.

The third refers to the need to ensure that currencies of trading countries are relatively stable. Otherwise traders may not be willing to take the risk to denominate their transactions in domestic or regional currencies.

A sharp fall in the value of the domestic currency would easily wipe out whatever gains or profit exporters expect to receive given the high import content of their exports. Herein lies the dilemma for, if the domestic/regional currencies are in a stable environment, then there is no longer the need for the regional arrangement which tries to mitigate the effects of the present volatility of regional currencies.

The dilemma lies in the differences in the basic objectives of the BPAs. The BPA has been part of Malaysia's strategy to diversify her export markets into non-traditional territory in which Malaysian traders have very little experience, and/or confidence, in their trading system.

The guarantee by Bank Negara to create confidence among potential traders is only against non-payment of export receipt by importing partner countries and it is not to cover losses due to volatility in the exchange rate, hence the inappropriateness of the BPAs in the present context to increase intra-Asean trade as a means to reduce the region's reliance on the US dollar.

We may conclude that the proposal to increase intra-Asean trade based on the export competitiveness of the regional product is a move that should be pursued more vigorously than before. There is an urgent need to further liberalise intra-Asean trade in the context of the Afta process.

This implies bigger cuts in intra-regional tariffs as well as a wider coverage of the CEPT inclusion list to cover those products that are of trading interest to Asean countries. Increasing intra-Asean trade through the BPAs may serve as an interim measure at best insofar as it does not add any new distortion to the regional trade regime. And, needless to say, promoting intra-Asean trade through the BPA mechanism and using regional currencies is easier said than done, given the present volatility of the regional currencies.