

# FREE TRADE AGREEMENTS AND SOUTHEAST ASIA<sup>1</sup>

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Since the 1980s global trade and foreign investment have expanded markedly. In the process, millions have left rural villages and agricultural work to find opportunities in cities and manufacturing centres. Foreign direct investment (FDI) has long been touted as the engine for the economic development that will jump start domestic investment and consumption. The most recent manifestation of this proposition is seen in renewed efforts to expand free trade agreements.

According to its proponents, free trade helps nations take advantage of the unprecedented wealth the global economy is producing. Several nations in Southeast Asia have received massive amounts of FDI during the previous 2-3 decades, and the number of factories producing for export has dramatically increased. Wealth has also increased, but for a limited number of people. A majority of the workers who labour to produce the exports which are driving many national economies in Asia and increasing trade globally are engaged in forms of employment where wages are low, work conditions are poor and the time one can be employed in the manufacturing sector is often short, as pools of younger job seekers are often available in abundance. This leads to the question of whether national and regional development based on FDI is sustainable, given the greater complexity and competitiveness of the global

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economy in attracting foreign investment, particularly with the sharp increase in bilateral and regional free trade agreements.

Since the 1980s the pattern in Southeast Asia, and other developing nations and regions, has been to suppress and maintain authoritarian control over labour and trade unions in order to maintain “investor confidence” and FDI inflows. FTAs are often falsely associated with improved labour conditions, more jobs, and better pay, but the reality is often far removed from this promise. Ignoring the hard lessons Mexico has learned after ten years of free trade and increased market access under the North American Free Trade Agreement (NAFTA), Thailand, which has implemented an FTA with Australia, is forging ahead on FTA negotiations with the US, Japan and a number of other nations and, if implemented, the consequences could be felt not only by manufacturing, service, and agricultural workers in Thailand (among others), but also regionally as the Thailand-US FTA has a high potential for spillover effects.

## **THE SIGNIFICANCE OF FDI IN SOUTHEAST ASIA**

The ten Association of Southeast Asian Nations (ASEAN)<sup>2</sup> members are a politically and economically diverse bloc of over 500 million people with a combined gross domestic product of US\$737 billion and a total trade of US\$720 billion (ASEAN 2005). It ranks behind only NAFTA and the European Union (EU) regional blocs in terms of market size. Despite the massive gulf in per capita income between ASEAN nations, reflective of disparities in economic and living standards, ASEAN is continuing to promote regional economic integration as a means to further expand economic development, with FDI as the driving force. FDI has generally been focused on manufacturing and, increasingly, services (see Table 1). Those Southeast Asian countries that have lacked the domestic financial resources necessary for export-oriented manufacturing have relied on FDI as a cornerstone of industrialisation and growth, and FDI has been considered a more stable form of investment, as opposed to short term bank and portfolio flows. Portfolio capital, or investment in government bonds and corporate stocks and bonds, which may be issued for terms as short as a few months, is considered more “footloose” than FDI. In short, as FDI entails activities such as the construction of offices and factories and acquisition of equipment, FDI is considered “longer term” capital and the most stable form of foreign investment. Its proponents believe that FDI also facilitates the transfer of intangible assets such as technology, skills, and management know-how, thus directly boosting productivity and growth. From the perspective of investors, Southeast Asia has been an attractive investment destination based on its strategic geographical position, ownership advantages, market potential, and returns on investment. In terms of foreign ownership, investors have strong control over their products, patents, technologies, production processes, marketing, and management techniques, in many cases more so than in their home countries (see Daquila 2002).

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<sup>2</sup> ASEAN was established in 1967 by the five original member countries: Indonesia, Malaysia, Philippines, Singapore, and Thailand. Brunei Darussalam joined in 1984, Viet Nam in 1995, Laos and Burma (Myanmar) in 1997, and Cambodia in 1999.

**Table 1: Distribution of FDI stock, by industry, selected Asian economies, 1995 and 2002 (%)**

Economy	1995			2002		
	Primary	Manufacturing	Services	Primary	Manufacturing	Services
China	1.6	58.5	36.1	1.9	63.3	31.4
Hong Kong	-	8.3	91.7	-	2.8	93.0
Indonesia	18.2	64.5	17.2	--	--	--
Malaysia	4.5	52.7	33.5	24.0	38.0	38.0
Philippines	17.0	55.0	28.0	10.9	39.3	43.9
South Korea	0.2	62.2	35.2	0.5	57.4	42.0
Singapore	-	38.2	61.7	-	36.1	63.8
Thailand	6.0	36.6	57.4	2.4	37.7	56.8

Source: UNCTAD (2004)

In the 1980s and 1990s, prior to the Asian financial crisis, many Southeast Asian economies experienced surges in FDI, particularly in export sectors where transnational corporations (TNC) initially sought low-wage workforces where authoritarian governments, keen on maintaining investor confidence, limited workers' rights. This was particularly the case for those Asian FDI source nations such as Japan, Taiwan, Hong Kong, and South Korea, where wages had been on the rise from the 1980s, in the case of Japan much earlier, and where there had been the development of more independent, democratic trade unions. Noting the success of the first generation Asian developing countries and regions (Taiwan, Korea, Singapore, and Hong Kong) Southeast Asian nations keen on fast track capitalist development such as Indonesia, Malaysia, the Philippines and Thailand offered corporations not only cheap labour, but also deregulation of investment so that foreign productive capital could operate freely and deregulation of trade so that importing raw materials and exporting goods would be cost effective and profitable (see Chang, 2004). They were later followed in this area by Cambodia, Vietnam, China and others. Southeast Asia has received three types of FDI since the 1950s: first, in natural resources; second, investment that enabled foreign investors to access the regional market by setting up industries to produce cheap consumer goods for local markets; and third, the previously mentioned export-oriented FDI, which investors used in the region as a production and export base for manufactured goods, with successive waves of inward FDI from East Asia, North America, and Europe. Indonesia, Malaysia, the Philippines and Thailand developed arrangements that liberalised capital flows and deregulated labour practices in ways that, to varying degrees, led to significant economic growth, resulting in a dramatic economic transformation over the past several decades.

This transformation in Indonesia, Malaysia, the Philippines and Thailand began in the late 1960s, with a gradual shift from import-substitution industrialisation (ISI), which is a process of restricting imports that compete with domestic products, to export oriented industrialisation (EOI) which relies heavily on FDI, particularly in manufactured goods. Singapore had the shortest ISI period in Southeast Asia due to its small domestic market and lack of natural resources, while the Philippines had the longest standing ISI period which led to the development of an inward-looking manufacturing sector and an urban-based development policy (on Singapore, see Rodan 1992; for the Philippines, see Daquila 2002). Singapore was the first Southeast Asian economy to make the switch to EOI, in addition to the shift from labour intensive manufacturing to more skill-oriented, high-technology and high-value-added

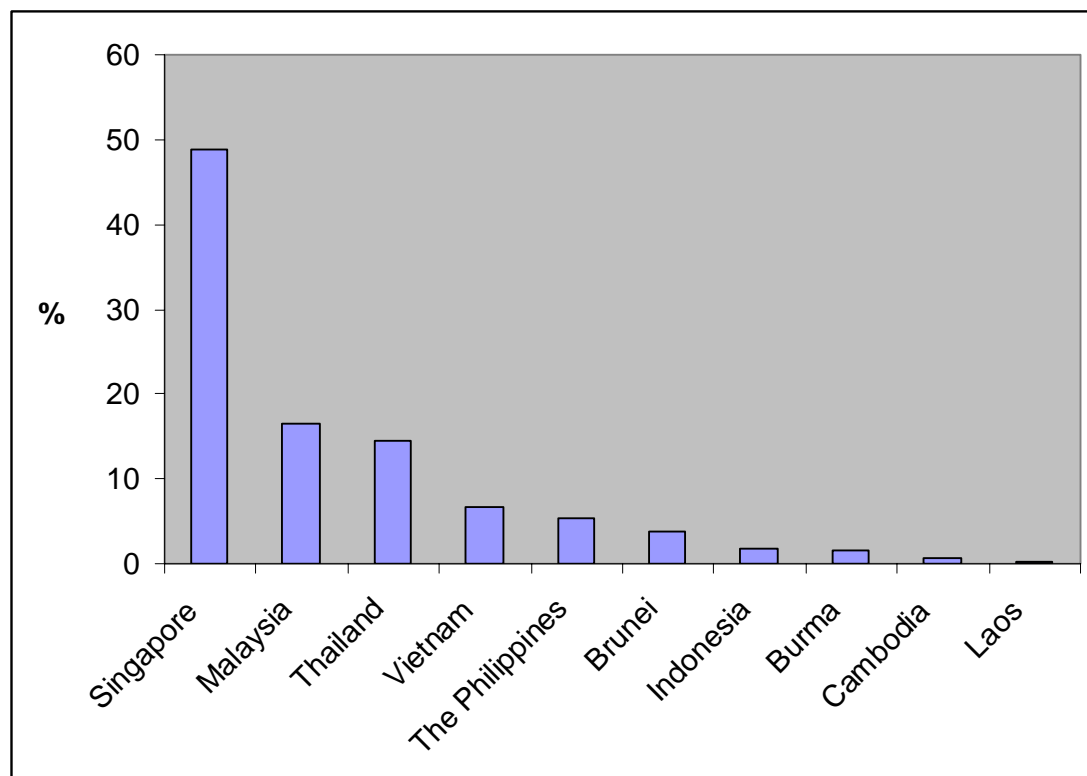
industries, a shift that, as will be discussed later in the paper, other Southeast Asia nations are struggling to make. As can be seen in Table 2, the relative size of FDI has varied considerably across the Asian region and, for the ASEAN economies, there is significant variation, with Singapore receiving almost half of all recent flows of FDI (see Figure 1).

**Table 2: Average FDI Inflows in Asian Countries/Regions**

Economy	Inward FDI as a % of Gross Domestic Investment	
	1987-1992	1993-1997
Hong Kong	9.9	10.2
Indonesia	2.7	6.1
South Korea	1.1	1.1
Malaysia	18.1	14.1
Singapore	32.2	27.0
Taiwan	3.3	2.8
Thailand	5.6	3.8

Source: UNCTAD (1999).

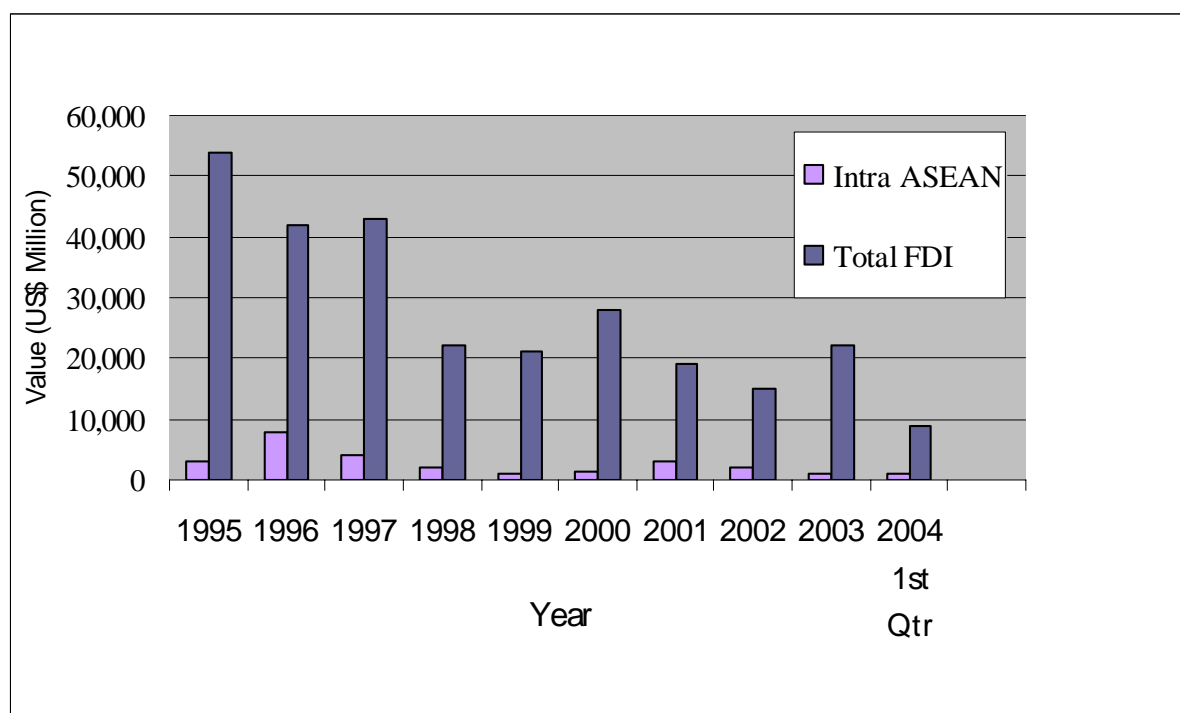
**Figure 1: FDI Inflows to ASEAN by Host Country, 1995-2003 (as a % of FDI to the region)**



Source: ASEAN Secretariat (2004).

Globally FDI flows have risen sharply in two phases (see Freeman and Bartels, 2004). The first phase, from 1985 to 1990, saw global annual flows boom from roughly US\$55 billion to US\$202 billion. During this phase Southeast Asia's share expanded nearly five-and-a-half times, from US\$2.2 billion to US\$12.1 billion, with Singapore accounting for roughly 50 percent during this period, while Malaysia, Indonesia, and Thailand accounted for most of the remainder. FDI in this phase represented the continuing international relocation of production. The second distinctive phase for Southeast Asian FDI flows corresponded to a period of global FDI growth, when world FDI flows expanded from US\$320 billion to US\$1,436 billion per annum from 1995 to 2000. However, contrary to the earlier period of growth, when FDI to Southeast Asia was increasing, this phase witnessed a sharp decline in total FDI (see Figure 2). FDI flows to individual ASEAN members vary considerably, and although absolute amounts of FDI have stabilised since 2000, following the Asian financial crisis, ASEAN's proportion of FDI within Asia has declined from the levels it received in the mid-1990s. FDI inflows dropped in Southeast Asia from US\$27.7 billion in 1997 to \$14 billion in 2002 (see UNCTAD WIR, 2003). A large measure of the overall decline in ASEAN is explained by disinvestment from a few regional economies, particularly Indonesia, where foreign investor confidence plummeted, combined with a global slowdown in FDI that saw total investment decline from US\$1,436 billion in 2000 to US\$679 billion in 2001.

**Figure 2: Investment Flows to ASEAN and Intra-ASEAN Investment Flows to Manufacturing Industry, 1995-1st Quarter 2004**



Source: ASEAN Secretariat (2004).

Through the 1980s to the late 1990s Indonesia, Malaysia, the Philippines, Thailand and Singapore were well positioned to attract relatively large portions of the increased global FDI. However, just as productive and investment capital moved from the

developed economies to first generation Asian developing economies and to Southeast Asia, more attractive host nations (re-)emerged in the 1990s including China, and parts of Eastern Europe, Latin America, South Asia and Southern Africa. When combined with the impact of the Asian crisis, levels of FDI have declined or stagnated for much of Southeast Asia. To a large extent the problems of attracting FDI in Southeast Asia today are due to their success: other developing countries have seen that FDI could be used to promote capitalist industrialisation, so competition has increased, meaning that Southeast Asia may never see a return to the high levels of global FDI flows it was able to attract in the past.

Greater FDI flows to one nation or region do not necessarily imply less to other countries or regions. However, recent years saw a slowdown in FDI and competition to attract it intensified. Those Southeast Asia countries pursuing EOI have sought to find ways to ensure that investors don't pass them by. As a regional group, ASEAN is attempting to increase its attractiveness via such measures as the ASEAN Free Trade Area (AFTA)<sup>3</sup>, which attempts to offer higher risk-adjusted returns to investors; however, given the divergent levels of socio-economic development among Southeast Asia countries a comprehensive plan or ambitions for such measures as a single market are many years away. Among other objectives AFTA is an attempt to lock member nations into structural reforms, deregulation, and liberalisation of domestic markets to promote competition, phased reductions in tariffs on manufactured imports from ASEAN members through the Common Effective Preferential Tariff schemes, and a forum for conducting trade talks with significant sources of investment such as Japan, Korea, the US, and EU, and to secure a foothold in nations with massive market potential such as China, and ASEAN's biggest export market, the US.

By promoting itself as a group of closely co-operating economies with a large combined market, rather than self-interested nation-states, ASEAN's strategy is to attract non-ASEAN FDI by facilitating intra-ASEAN FDI. Singapore, Malaysia and, to a lesser extent, Thailand, are becoming a significant source of FDI in Southeast Asia pursuing a production division of labour within ASEAN, while simultaneously promoting their maturing economic potential in terms of market size, market growth, and investment incentives to foreign TNCs. Those Southeast Asia TNCs operating in Vietnam, for example, may pursue a strategy of attracting FDI from or in partnership with non-ASEAN TNCs or their subsidiaries in the region. Regional integration also encourages reinvestment by TNCs, prevents their departure, and can target new, perhaps smaller TNCs in industries not yet present in Southeast Asia.

However, to promote investment on the national, regional, and international levels, a wide range of policies need to be initiated under AFTA and the ASEAN Investment Area such as: policies to ensure regional political and economic stability; trade related measures such as AFTA, WTO, and FTAs; reduction in restriction on foreign investors; creation of an enabling environment for FDI such as knowledge or technology base, good physical and communication infrastructure, transparency of laws, quality workforce, and ASEAN-wide harmonisation of FDI policies, laws, and regulations; and incentives for FDI (see Mirza, 2002).

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<sup>3</sup> AFTA was formulated in 1992 when it was declared that a free trade area would be established by 2008, though this date has been pushed back.

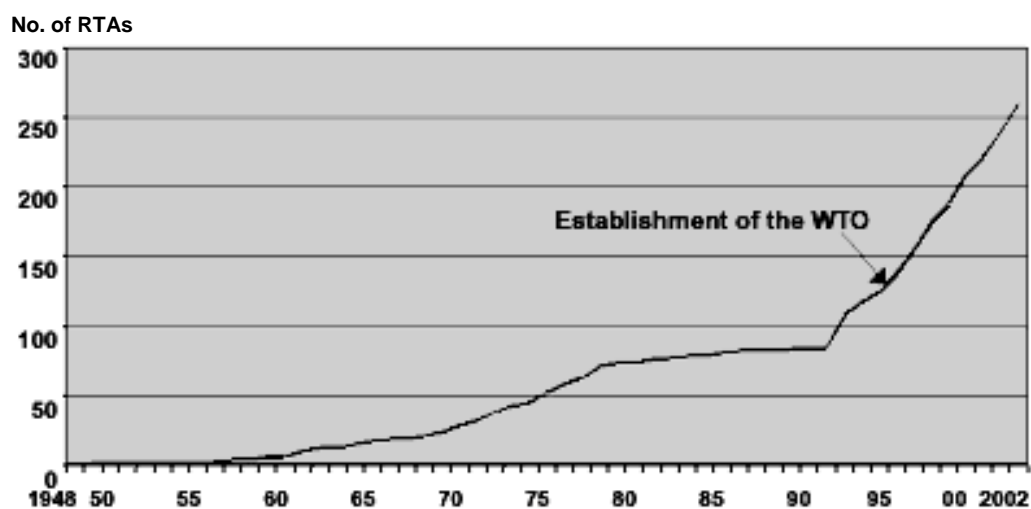
The longer term effect of these policy measures, broadly categorised as neo-liberal structural reforms, and their implications, such as greater reliance on FDI from TNCs for development and promoting an intra-ASEAN division of labour, are questionable at best, and will be examined below. Opponents of neo-liberal globalisation are not necessarily opponents of regionalisation. For example, they contend that nations and regional groups could be important actors in a process of economic “devolution” and be developed beyond their current manifestations, which inherently reinforce division of labour among countries (see Bello 2002), while Mirza (2002) and other economists consider regionalisation to be a natural process that needs to be encouraged. Development of a sustainable industrial base, whether for export or the local market is an objective most can agree upon, but how to ensure the necessary access to technology, backward and forward linkages and other necessary components of industrial development is a difficult agenda for which there are few viable alternatives, other than a continued reliance on FDI and TNCs or governments. Currently, many developing nations and regional groups such as ASEAN are at a significant turning point in the increasingly competitive global economy. Both the nationalist-protectionist import substitution and the export-oriented strategies which were so effective for East Asia’s Newly Industrialised Countries and, for a time, for others including Malaysia and Thailand, now face challenges. In the new phase of global capitalism, less developed economies are now forced to deal with global markets which are not hospitable to any form of protectionism or state-initiated policies, and “markets” are now quick to discipline any policy seen as discriminatory or contradicting free market principles as TNCs seek more hospitable environments.

The remarkable proliferation of bilateral and regional FTAs since the mid-1990s is in part due to attempts to lock economies and regional blocs into the global economy (see Figure 3). If negotiated on an equal footing among developing and advanced economies, regional and multilateral trade agreements can be conducive to sustainable socio-economic development (although this has not been accomplished in the World Trade Organisation, NAFTA etc.), bilateral FTAs tend to be disempowering for developing economies, leaving them at a considerable disadvantage. There are a number of reasons for this, not least being the limited capacity and experience of developing country trade negotiators in conducting trade negotiations, sometimes multiple and simultaneously, with powerful rich countries.

## **THE COMPLEXITY OF FTAS AND US AMBITIONS IN SOUTHEAST ASIA**

Contrary to mainstream globalisation theories, the reality of the global free trade regime is that it is increasingly being segmented into regional arrangements and a highly complex web of free trade deals. While these arrangements are generally congruent with WTO rules and are reported to the WTO, there can be no doubt that these arrangements offer a challenge to the global neo-liberal vision. While globalisation and economic interdependence among national and regional economies are becoming more significant, it is important to remember that national policies and domestic economies remain the principal determinants of economic affairs.

**Figure 3: Evolution of Regional Trade Agreements, 1948-2002**



Source: WTO Secretariat (2004).

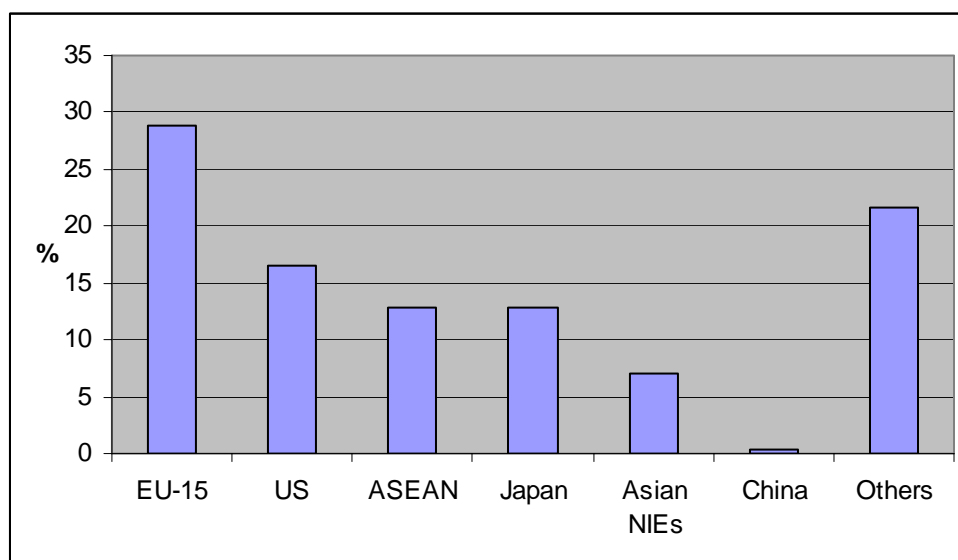
It is in the context of a recent slowdown in multilateral negotiations at the WTO that various regional groups and countries have sought bilateral and regional FTAs that permit further liberalisation. These strategies include a range of dialogues: with the US under its Enterprise for ASEAN Initiative (EAI); negotiations for ASEAN-Japan and ASEAN-China free trade initiatives; initial discussions regarding ASEAN Plus Three plan (ASEAN, Japan, South Korea, and China<sup>4</sup>); and discussions among ASEAN, China, Japan, South Korea, Australia, and New Zealand under the proposed ASEAN-Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). In July 2003, the EU proposed a plan for trade and investment co-operation with ASEAN, called the Trans-Regional EU-ASEAN Trade Initiative (TREATI), which is significant for ASEAN as the EU was its largest source of FDI from 1995-2003 (see Figure 4). US FTAs are the primary focus of this paper – and of much of the research on FTAs – yet it is arguably the EU that triggered the initial rush toward regional and bilateral FTAs. This is because it is the EU that has been, and remains, the most prolific pursuant of bilateral and regional trade agreements.

The US is also among the top sources of FDI for ASEAN and, significantly, is ASEAN's largest export market, in addition to being the world's most powerful economy, and leader of global capitalism. This means that ASEAN domestic policy makers, as well as those operating at the regional level, are keen to secure deals with the US, particularly as the US has been highly selective in the negotiation of its handful of FTAs in Asia.

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<sup>4</sup> Japan, South Korea, and China have only recently entered into regional trade agreement negotiations. South Korea has concluded an FTA with Chile and is conducting negotiations with Thailand, and importantly, Japan has implemented FTAs with Singapore, Malaysia and Mexico in addition to the negotiations with ASEAN.

**Figure 4: FDI Inflows to ASEAN by Source Country, 1995-2003**



Source: ASEAN Secretariat (2004).

The EAI was initiated by the Bush administration in November 2002 and is modelled upon the Enterprise for America Initiative, launched in 1990, that led to NAFTA negotiations. The EAI is a “road map” for the member countries of ASEAN to pursue FTAs with the US. The first of these was the US-Singapore FTA (USSFTA), which is now the de facto model for other ASEAN negotiators. For example, Thailand, which began FTA negotiations with the US in June 2004, has followed the USSFTA despite the fact that Thailand and Singapore are quite different in terms of economic structure and level of development. The only requirements to enter FTA negotiations under the EAI are that the Southeast Asian nation is a member of the WTO and has signed a trade and investment facilitation agreement (TIFA) with the US. TIFA discussions are wide-ranging and provide the foundation and indicate intent for formal negotiation of a bilateral FTA with the US. To date, Brunei, Indonesia, the Philippines, Malaysia and Thailand have each signed a TIFA (Office of the United States Trade Representative 2004a).

The US has long and valuable experience in negotiating and implementing FTAs. It has an FTA with Canada and Mexico under NAFTA, and has implemented FTAs with Jordan, Chile, Singapore, Australia, Morocco and Bahrain.<sup>5</sup> The US has also signed FTAs with Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica and the Dominican Republic under the Central America Free Trade Agreement (CAFTA), and is currently negotiating FTAs with ten more countries: Panama, Colombia, Ecuador, Peru, Thailand, and with the five nations of the Southern African Customs Union – Botswana, South Africa, Lesotho, Swaziland, and Namibia. The Free Trade Area of the Americas negotiations include all but one of the 35 nations of the Western Hemisphere since 1994 (of course, the exception is Cuba). It is noteworthy that, with

<sup>5</sup> In May 2003, US President Bush also announced an initiative to create a Middle East Free Trade Area (MEFTA) by 2013. The initiative is designed to deepen US trade relationships with all countries of the region (see USTR, 2004c).

two exceptions – NAFTA (1994), and its precursor the Canada-United States Free Trade Agreement (1989), and the US-Israel FTA (1985) – all of these agreements were concluded and implemented during the Bush presidency (2000-present). Their proliferation marks a significant shift in the US trade agenda, which until 2000 had emphasised multilateral agreements under the WTO. Some have argued that this reflects a shift of emphasis that began toward the end of the Clinton administration, but accelerated under Bush, and represented the ascendancy of the neo-conservative foreign policy agenda and the weight given to security issues post-9/11 (see Higgott, 2004).

### **Competitive liberalisation**

The US policy of competitive liberalisation, as US Trade Representative (USTR) Robert Zoellick stated on behalf of President Bush, refers to the US strategy of pressing ahead with trade liberalisation on three fronts: globally, regionally, and bilaterally (see DeRosa, 2004). The logic is that by advancing on multiple fronts, the US is positioning itself at the centre of a global network of initiatives to open markets through competition. Essentially, the US is seeking to lock strategic partners, politically and economically, into market liberalisation for fear that they may lose out if they do not sign up with the US.. These bilateral and regional FTAs are valuable to the US, and especially for US TNCs, in that they free trade with significant and strategic economies such as Singapore and Chile. The proponents of FTAs feel that they also encourage partner nations to continue multilateral negotiations at the WTO; FTAs essentially lock these partners into further trade liberalisation. Furthermore, it is in the economic interests of nations such as Singapore to pull other regional economies along the same path, as their investors and businesses strive to tap into emerging markets and increase investment options and opportunities. Once significant economies in the region (such as Singapore and Thailand) have implemented or are negotiating FTAs with the US, other nations such as the Philippines or Indonesia are pushed along the same path. This US strategy has developed from the failure of the WTO's multilateral ministerial meetings in Seattle and Cancun and the previously mentioned rise of regionalism. The risk of a continued failure on the multilateral level has led to the US aggressively forging bilateral and regional arrangements. While these arrangements lack the scope of the WTO-led arrangements and amount to a slower pace of trade liberalisation, they are deemed preferable to the essentially stalled WTO talks and negotiations.

The US is often perceived as promoting a world dominated by markets. In reality, however, US economic and security concerns are strongly intertwined; security issues are a major consideration in economic policy making in Washington. This has become especially clear under the Bush administration. For example, in addition to trade related concerns, the US is linking geopolitical security issues tied to the “War on Terror” by offering trade deals to those who co-operate with the agenda of US military aggression in Iraq (Higgott, 2004). This was certainly a central consideration in the US FTA negotiations with the Morocco and Bahrain FTAs under the Middle East Free Trade Area. In Southeast Asia, Thailand's FTA negotiations with the US developed momentum only after Prime Minister Thaksin Shinawatra gave his support to the “War on Terror”, and Indonesia will also feel this pressure in deciding FTA arrangements with the US (see Glassman, 2005). It is noteworthy that Malaysia's then Prime Minister Mahathir Mohamad not only opposed the “War on

Terror” but also the proliferation of bilateral FTAs in Southeast Asia, considering FTAs incompatible with ASEAN’s longer term strategy under AFTA. However, since Mahathir stepped down in October 2003, the following May, Malaysia has signed a TIFA with the US.

The context described above is important, but these bilateral FTAs also have to be considered for their promises of market access, more jobs, and higher pay. To do this it is instructive to examine the impact of NAFTA in these areas. In fact, as will be indicated, NAFTA is a strong case against FTAs and raises questions regarding US motivations. The US has only so much market to offer its trading partners, and some analysts assert that the US has nearly reached its limit on the trade concessions it can offer (see Freeman and Bartles, 2004), so the crux of the EAI and other FTAs is that the US is intent on boosting trade, and especially US exports, in a wide range of goods and services, in addition to permitting unrestrained capital flows for TNCs.

### **THE CASE AGAINST FTAS - LEARNING FROM NAFTA**

A majority of global trade and FDI flows occur among the world’s advanced economies – the US, EU, and Japan – and over the past 20 to 30 years the trade regime of these nations, and consequently the global economy, has been radically altered. A number of factors, which go beyond the scope of this paper, contribute to these changes, broadly defined as political, economic and technological developments. The end of the Cold War and the Soviet command economy, and along with it the advent of China’s “Capitalism with Chinese Characteristics,” the stagnation of Third World ISI strategies and the success of the US economy in the 1990s have, in combination, led to a greater acceptance of the idea that unrestricted markets and the free flow of capital and goods are the answers to the economic troubles of developing countries.<sup>6</sup>

Due to the increased political and economic pressure for liberalised markets in the WTO and Bretton Woods institutions, and the increasing economic vulnerability of nations in the global economy, political and economic regionalism has gained considerable impetus. And, as the international economy has become more closely integrated, regional groupings of states have increased their co-operation in order to strengthen their autonomy, improve their bargaining positions, and promote other objectives (see Gilpin, 2001). This is recognised globally, through the WTO, and has prompted the rush for bilateral and regional FTAs.

Free trade and FTAs are often foisted on the public in poor countries as formulae that will bring economic prosperity and development to the nation and people, promising that export markets will expand and industry will develop. However, liberalisation is a slippery slope. If developing countries hope to “take advantage” of FTAs, they must pursue domestic economic policies – together with trade reforms – which mean they must liberalise their internal trade and remove regulatory barriers in order to attract foreign investment. This is, of course, a key rationale for entering FTAs. Structural reform is essentially locked into FTAs, making liberalisation difficult to reverse once begun.

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<sup>6</sup> This is not to deny that there is a legitimacy crisis of these neo-liberal claims (see Robison and Hewison, 2005).

The Ministerial Declaration from the First Summit of the Americas (FTAA, 1994) promised:

Our continued economic progress depends on sound economic policies, sustainable development, and dynamic private sectors. A key to prosperity is trade without barriers, without subsidies, without unfair practices, and with an increasing stream of productive investments. Eliminating impediments to market access for goods and services among our countries will foster our economic growth. A growing world economy will also enhance our domestic prosperity. Free trade and increased economic integration are key factors for raising standards of living, improving the working conditions of people in the Americas and better protecting the environment.

In examining the impacts of free trade agreements, however, NAFTA and Mexico present a picture that is far removed from the promises made about free trade, with significant and negative impacts for workers and particularly the rural poor.

### **Mexico under NAFTA**

In the early 1980s Mexico moved from its economic strategy of ISI to EOI due primarily to a massive external debt that had sparked a major economic crisis in 1982. With the EOI strategy Mexico liberalised its economy by reducing the size of the public sector, promoting land ownership reform, and committed, in 1991, to negotiations for an FTA with the US and Canada. This FTA came into force in 1994 as NAFTA. In terms of trade and investment for US-based TNCs, NAFTA has been a great success (see Brown, 2004). For example, Mexico's exports almost tripled between 1993 and 2002 (\$67.5 billion to \$187.4 billion) and FDI totalled more than \$124 billion in the same period, with FDI from the US jumping 204 percent. Labour productivity has risen 45 percent since 1995. In fact, Mexico's economy has become completely dependent and intertwined with the US, with 65 percent of Mexico's imports from the US, and 89 percent of its exports going to the US. More than 40 percent of the US-Mexico trade is actually intra-corporate trade within divisions or subsidiaries of the same company. However, the per capita GDP of Mexico was the same in 2003 as it was in 1980, and the annual GDP growth rate during NAFTA averaged one percent.

After 20 years of trade liberalisation and 10 years of NAFTA, Mexico has failed to achieve the level of development promised by the proponents of free trade. As the first developing country in the world to sign a major trade deal with a developed country there are many lessons to be learned for other countries attempting to use trade liberalisation with the US as an engine of sustainable economic development.

The 10-year anniversary of NAFTA produced more than two-dozen reports analysing its impacts for Mexico. These reports variably characterise the liberalisation of trade as "not enough" for sustained economic growth to "broken promises" for broad social development (see Brown, 2004, citing the World Bank and Joseph Stiglitz).

NAFTA was marketed in North America largely by political and business leaders who asserted that NAFTA would create jobs and lead to higher wages. Although the volume of manufactured exports has grown under NAFTA, the much-anticipated growth in employment and quality of employment has not accompanied it. Initially, rapid growth in trade, increasing productivity, and a surge in both portfolio investment and FDI led to an increase of 500,000 Mexican jobs in manufacturing from 1994 to 2002. However, about 30 percent of the jobs that were created in maquiladoras (assembly plants that manufacture finished goods for export, mainly to the US) in the 1990s have since disappeared (see Audley, 2004).

One explanation for the uninspiring job growth is increased productivity. However, this productivity increase has been fairly modest, and it alone cannot account for the limited growth in manufacturing employment. Another explanation is that the manufacturing model used in Mexico relies largely on assembly. This means that parts are imported, then processed or assembled, and re-exported. This model produces few backward and forward linkages, such as the stimulation of domestic businesses that supply parts and materials. In the maquiladora sector, 97 percent of components are imported, with a feeble three percent produced locally. Similar patterns are found in the non-maquiladora sectors in the auto and electronics industries that also rely heavily on imported inputs. Other factors in the recent decline include the loss of jobs in manufacturing for the domestic market, due to imports, and importantly, the fact that Mexico has lost its advantage as the first mover on an FTA with the US.

With lacklustre growth in manufacturing jobs, Mexicans displaced by the loss of employment in agriculture face the obvious difficulty in adjusting to the new job possibilities under NAFTA, and these factors may have contributed to the overall loss of jobs in Mexico since the enactment of NAFTA. In 1993, 8.1 million were employed in agriculture, but by 2002 there had been a loss of 1.3 million jobs in this sector (see Polaski, 2003), due primarily to the increasing competition with subsidised US agricultural imports. As Mexico has no unemployment insurance and no safety net for displaced workers due to NAFTA implementation, large numbers of Mexicans who lost work have been forced to find other employment. This has resulted in the informal sector growing through much of the 1990s, and it now accounts for roughly 46 percent of Mexican jobs. As the most sensitive agricultural tariffs are not due to be reduced until 2008, the outlook is bleak for Mexico's workers. Agricultural workers are unlikely to be absorbed by the export production sector, meaning even greater difficulty for displaced workers in Mexico. One result of this has been the dramatic rise in the number of Mexicans seeking work in the US. According to the US Department of Homeland Security (n.d.), Mexico is the largest source country for unauthorized immigration into the US. The estimated unauthorised resident population from Mexico increased from about two million in 1990 to 4.8 million in January 2000. Over the same period, Mexico's share of the total unauthorised resident population increased from 58 to 69 percent.

Another central rationale for entering NAFTA was that wages would rise. This failure has been the most striking reality for Mexico. Despite the dramatic increase in exports and FDI, wages have not risen; in fact, they are below pre-NAFTA levels for production workers, highly educated workers in the manufacturing sectors, and

workers with university and even postgraduate degrees in other sectors (Polaski, 2003).<sup>7</sup>

Mexico began the transition to a liberalised economy in the 1980s and NAFTA has accelerated it without creating the necessary conditions for the public and private sectors to respond to the economic and social shocks of trading with two of the biggest and most powerful economies in the world. A significant proportion of Mexicans have faced relentless change which is beyond their capacity, or that of their government, to mitigate or control.

### **The North American Agreement on Labor Co-operation**

The “labour side agreement” of NAFTA is the North American Agreement on Labor Co-operation (NAALC), signed by Canada, Mexico, and the US. Its stated objective is to “protect, enhance and enforce” 11 major labour principles which include a wider range of issues than the eight Core International Labour Organisation (ILO) Standards, including protections for migrant workers and workers’ compensation. The NAALC is widely regarded as a failure in protecting, enhancing, and enforcing labour rights due to a lack of political will to implement the agreement (see Brown, 2004 and Delp et al., 2004). Part of the problem is that Mexico has been unable and unwilling to enforce labour rights, due to pressure to maintain “investor confidence”, limits on government resources, and longstanding problems with corruption in the government’s labour ministries and departments. The NAALC contrasts sharply with NAFTA’s Chapter 11, which allows corporations to sue the NAFTA governments whose laws or policies the corporation believes have limited or prevented corporate profits. The mechanisms under NAALC are non-enforceable, and complaints can only be filed with the National Administrative Offices of another NAFTA country. Employers cannot be ordered to reinstate unjustly sacked workers, there is no available remedy or compensation available for workers who suffer from violations of national laws due to non-compliance by their employers, and workers have no way to participate in the process beyond submission of their complaints.

The 10-year experience of NAFTA in Mexico is best summarised as the stark contrast of winners and losers, winners being primarily US-based corporations, and losers the rural poor and workers in domestic manufacturing and agriculture in Mexico. When comparing the labour enforcement under NAALC and corporate enforcement provision under Chapter 11 of NAFTA and its labour side agreement, it is easily seen that the corporate logic of NAFTA driven by low-cost production in Mexico for the US market and the sale of US goods in Mexico has been at the expense of sustainable socio-economic development for Mexico.

### **THE ENTERPRISE FOR ASEAN INITIATIVE AND LABOUR CONDITIONS**

In most Asian countries trade unions and labour movements have not been particularly active participants in campaigns against the WTO and FTAs. Exceptions have been the international departments of the Korean Confederation of Trade Unions, the Hong Kong Confederation of Trade Unions, the State Enterprises

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<sup>7</sup> The peso crisis of 1994-95 was a significant setback for wages in Mexico. However, the increase in FDI, other investment and productivity has not let to increases in wages.

Workers Relations Confederation of Thailand, and a number of state enterprises and service sector unions in the Philippines, among a handful of others. One reason for this is information about the WTO and FTAs is often perceived as abstract and not directly relevant to workers. This is especially the case as much of the information is focused on intellectual property rights, agriculture, services and the like. Such issues are not usually of immediate concern for workers in sectors other than state-owned enterprises which are being privatised under neo-liberal reforms. With the increasing prominence of FTAs globally, certain trade unions' understanding of them is that FTAs could help generate compliance with international labour standards and help secure export markets, which in turn are supposed to create greater job security, improved work conditions, and kinds of work through increased technology transfer, and lead to higher paying jobs.<sup>8</sup>

While building an ASEAN-wide investment promotion base, individual Southeast Asia nations are also pursuing policies and measures that could have profound effects on their neighbours. Bilateral FTAs in Southeast Asia will have far-reaching impacts, far beyond the two countries involved. It is already noticeable that as FTAs are developed and signed, that other governments feel increased pressure to enter FTAs. Already, it is clear that aspects of these FTAs have a high potential for negative social and economic consequences for the workers and the rural poor. This is particularly the case for Thailand, Indonesia, and the Philippines, with wide and increasing gaps in income distribution, and a majority or large proportion of its citizens employed or involved in the agricultural sector. As is currently the case in Mexico, there is potential for massive job displacement in agriculture due to the influx of subsidised imports from both the US and the EU. In addition, agreements with China offer the prospect of low cost Chinese imports that could also cause major disruptions to these countries, and displace many workers. Likewise, as the Mexican experience under NAFTA has proven, liberalised trade and FTAs are no guarantee that employment options or wages will improve in manufacturing sectors.

### **The US-Singapore FTA – A template for future FTAs in Southeast Asia?**

The labour and environment provisions of both the US-Singapore and US-Chile FTAs are touted by the US Government as “providing groundbreaking co-operation in promoting labor rights and the environment” (see USTR, 2003). This assertion requires careful examination; here we scrutinise the details of the labour provisions of the FTA agreed by Singapore and the US, although a similar case could be made for environmental standards.

First, and most notably, the USSFTA does *not* require signatories to adopt and enforce core ILO labour standards. The only enforceable labour and environmental standards included refer to the enforcing of *existing* domestic standards and laws, regardless of their adequacy. There is nothing in the USSFTA that requires the establishment of improved standards or which prevents signatories from lowering

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<sup>8</sup> These comments are based on the author's participation in seminars relating to trade and FTAs, and other discussions with academics, trade unionists and activists throughout Southeast Asia. The seminars were held in Thailand and the Philippines (December 2004-April 2005). An ILO official has recently noted the potential for the Thai-US FTA to improve labour standards (*Bangkok Post*, 8 August 2005).

existing standards. These points are significant and remain misunderstood in many of the countries that are currently considering an FTA with the US.

It is worth noting that under the US-Jordan FTA there are provisions that state that signatories should establish standards and prevented the lowering of existing standards. The USSFTA therefore represents a rollback from the US-Jordan FTA in that there is no parity of enforcement of labour standards with other measures such as those protecting commercial interests.

Under the existing Generalized System of Preferences (GSP) the US is able to deny trade benefits if nations have not taken, or are not taking, steps to afford internationally recognised worker rights. While this system is highly flawed and does little to improve workers' rights in the huge number of developing countries that trade with the US, that the US is now promoting an FTA model which *reduces* the enforcement of workers' rights needs to be understood. As the dispute mechanisms under labour provisions of the USSFTA provide only weak sanctions when established standards are breached, unions and labour activists need to be clear that, if a country is negotiating an FTA with the US, then appropriate national labour standards need to be established and enforced *before* an FTA is signed.

In its report to the US President, the USTR and Congress, the Labor Advisory Committee for Trade Negotiations and Trade Policy found that:

By focusing exclusively on enforcement of domestic labor laws, the Singapore and Chile FTAs end up creating a perverse incentive. Under the Chile and Singapore FTAs, a country that is challenged for failing to enforce its existing labor laws could simply weaken or eliminate those laws to avoid dispute settlement. A country could amend its laws to ban unions, allow child labor and forced labor, and invalidate all collective bargaining agreements, and face no possible penalty under the Chile and Singapore agreements. This makes a mockery of the agreements' one enforceable labor provision, essentially gutting the entire labor chapter of both agreements. This is an absurd and self-defeating policy that would not be tolerated in an area of concern to business.<sup>9</sup>

The crux of the USSFTA is expanded market access in goods, services, investment, government procurement, and intellectual property rights protection. As Singapore is already one of the most liberalised economies in the world, the USSFTA does not represent a dramatic shift in trade and investment policy. This will not be the case for countries such as it would be for Thailand, Indonesia, the Philippines, and other less developed economies.

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<sup>9</sup> It is worth noting that the Labor Advisory Committee was the only committee of the 31 USTR chartered advisory committees that did not support the final agreement on the USSFTA. Thus, movements opposed to FTAs with the US cannot expect significant support in Congress. However, Thailand's poor labour rights record is slated to be an issue in the Thailand-US FTA negotiations as the enforcement of labour standards in Thailand, particularly in the cases of children and migrant workers, is considered to be much lower than in countries which have already concluded FTAs with the US.

## **The Thailand-US FTA**

Thailand has been especially active in negotiating bilateral and regional FTAs. Recently, bilateral FTAs have been implemented with Australia, New Zealand, Bahrain, and China, and Thailand is negotiating, or expressed intent to negotiate, bilateral FTAs with India, Bangladesh, Sri Lanka, Pakistan, Saudi Arabia, Japan, Korea, Chile, Peru, Mexico, the US, Croatia, and the Czech Republic. Regional FTAs include: the previously mentioned ASEAN deals; negotiations under the Bangladesh-India-Myanmar-Sri Lanka-Thailand Economic Co-operation (BIMSTEC) agreement; AFTA-CER which includes ASEAN and New Zealand and Australia; the Greater Mekong Sub-region trade negotiations (involving Vietnam, Thailand, Burma, Cambodia, Laos, and Yunnan-China); and Asia Pacific Economic Co-operation (APEC) trade negotiations (see Thailand Development Research Institute, 2003). This broad array of bilateral, regional and multilateral trade negotiations means that Thailand's trade negotiators are exceptionally busy, and it is doubtful that they have the capacity to forge ahead effectively with so many trade deals at once.

As Thailand pushes ahead with FTAs, there is an impact on neighbouring countries in Southeast Asia, where a perception develops that they too must begin or accelerate extra-ASEAN FTAs if they are to keep up with the regional and global trends. The Thai government has not announced a position of "competitive liberalisation" in terms of its aggressive pursuit of FTAs, yet as a leading proponent of economic liberalisation under AFTA and in Southeast Asia, Thailand's current policy has this effect.

Of all the trade deals Thailand has signed and is negotiating, the Thai-US FTA has garnered the most attention both in Thailand and the region. The FTA will mean that US corporations will have the ability to more deeply penetrate the Thai economy than ever before, with potentially deeper and more profound impacts on the country and economy. Interestingly, studies indicate that the FTA will have negligible projected gains.

A TDRI study found that once the FTA is implemented the estimated real GDP growth rate is just 1.34 percent (see TDRI, 2003). TDRI also concludes that to benefit from the FTA in the longer term, Thailand must undergo a modernisation of its services sector and seek a diffusion of higher level of technology, know-how, and upgrade the labour and management skills that are essential for the Thai economy to move ahead and out of competition with lower-wage developing countries in the region, primarily China and Vietnam. Even if these changes are implemented, the increased competitiveness of Thai products on the US market, including sectors that are touted as "winners" of the Thailand-US FTA, such as autos, agricultural products, and textiles and garments, is not automatic. A major reason for this is that these sectors each constitute a significant domestic political lobbying group in the US, whether as business or organised labour, and are not likely to welcome increased competition from cheaper imports from Thailand. In addition, even if an FTA is signed, there remains the potential for non-tariff barriers to impede the flow of these goods to the US market.

### *The auto sector*

In the auto sector, Thailand promotes itself as “The Detroit of the East”, and has seen significant foreign investment, including from US manufacturers. However, the TDRI report to projects problems. To reap the benefits from access to the US market and further US investment in Thailand’s auto industry, Thai suppliers must reach international standards in three areas: quality, cost, and delivery time (see TDRI, 2003).

In terms of product quality, at present Thailand’s lower-tier parts suppliers are struggling with defect rates of more than 1,000 parts per million (ppm), while some assemblers such as General Motors (GM) have started to demand defect rates lower than 20ppm. US autos also require much higher environmental standards than suppliers in Thailand can currently meet. On cost, many of the major assemblers have set targets to reduce prices by 20-30 percent within two to three years. For example, GM has set a target of five percent per year cost reduction. While this is possible for many large, direct suppliers, smaller indirect suppliers, of which there are a high proportion in Thailand, will struggle to meet these goals. With shorter product life cycles and the adoption of just-in-time procurement by assemblers, suppliers not only need to strengthen quality control, but also would need to greatly improve design and test capabilities. Increasingly first-tier suppliers need to propose design to direct assemblers, which until recently used to order parts according to blueprints. This requires a huge investment in facilities and skills acquisition among domestic first tier suppliers, which is out of reach for most suppliers in Thailand. Additionally, suppliers need to adopt the use of information technology in their supply chain management to shorten lead time, lower inventory, increase interaction within the supply chain, and improve capacity in terms of procurement, production, and distribution. This requires large production volumes in order to be cost efficient (see TDRI, 2003).

It is evident that, in order to meet the above requirements for increased access the US auto market, major changes are needed, including all-important cost-saving measures. A useful comparison can be made with the textile and garment industry. This industry has undergone similar restructuring of supply chains over the past decade to accommodate just-in-time delivery, greater reliance on IT, and reorganisation of production into a complex web of suppliers and producers, while workers at the lower end of the supply chain have been squeezed into accepting lower wages, longer working hours, higher quality standards, and shorter lead times. Trade unions in the auto sector in Thailand, which are currently among the strongest in the private sector, are certain to bear the brunt of cost-saving measures, promoting an extension of already proliferating subcontract workers who are employed on a temporary basis through employment agents or brokers, rather than directly by the manufacturer. Given the relatively weak capacity of first-tier suppliers in Thailand it is possible that they could be replaced by foreign suppliers once local content requirements are eliminated under the proposed FTA, potentially eliminating crucial backward and forward linkages from the production process.

The TDRI FTA study examines only Thailand’s exports to the US market and does not detail imports from the US. The FTA’s primary benefit for the US is in creating market access. As the WTO has proven, the US is skilled at writing trade rules that protect its domestic goods and industries while gaining favourable export

agreements (see Bello, 2002). In addition to autos, huge growth is predicted for US exports of agricultural commodities, processed foods, textiles, and apparel (DeRosa, 2004), meaning a huge surge in US exports to Thailand and other nations in Southeast Asia considering a bilateral FTA under the EAI.

### *The textiles and garments sector*

Market access for textile and garments has long been a strategic tool of the US in inducing trade liberalisation among developing countries. A significant portion of the rationale for Central American countries in pursuing the CAFTA is increased, or at least continued, exports of textiles and garments to the US.<sup>10</sup> With Multifibre Arrangement quotas lifted in January 2005, developing nations with significant numbers of workers in that sector are keen to maintain or increase exports. It is ironic that a basic rationale for the Thailand-US FTA is the potential for Thailand to move away from low-wage and -skill sectors where its factories have difficulty competing with low-wage producers in Vietnam and China. At the same time, with over one million workers in the sector, the Thai government and the Thai Garment Manufacturers' Association are promoting the Thai-US FTA as necessary for maintaining jobs.

While the Thailand-US FTA would secure exports in the textiles and garments sector, particularly in the still limited number of higher-technology factories, competition will continue to be fierce. Given the number of FTAs the US is negotiating and has signed with developing nations and regions, a great many of which are significant textiles and garments exporters, there is sure to be significant competition for the US market, most particularly with Chinese-based manufacturers which have increased exports significantly since January 2005 (see Toh, 2005). Thailand's exporters can also expect political obstacles and protectionist measures from both the strong textiles and garments industry domestic lobby and industry unions in the US. The latter are particularly keen to protect members in an already decimated industry, and the strategy is to emphasise national self-interest rather than promoting solidarity among textile and garment workers in the US and in developing countries. This appears to be the case for most sectors of labour movements around the world, neglecting the potential for solidarity movements that target huge companies that profit through footloose production that seeks ever cheaper labour.

In Thailand, this pressure in the textile and garment sector, especially since the Asian financial crisis, has seen a steady increase of informal, subcontract, and contract workers (on sub-contracting, see Maniemai, 2003), in addition to a vast increase in the use of migrant workers who are paid roughly one-third to one-half of the minimum wage and enjoy virtually no labour rights, which they are meant to have under Thailand's labour laws (see Arnold and Hewison, 2005). Given the example of the exceptionally weak labour provisions under the USSFTA, there is reason to think that such provisions will be a part of the Thailand-US FTA. When combined with Thailand government proposals for Special Economic Zones (SEZs), such weak labour provisions will provide considerable incentives for manufacturers to relocate to SEZs that limit union activity or eliminate it altogether. This possibility will be

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<sup>10</sup> The comments draw on views expressed by both garment manufacturers and workers' organizations at a conference in Honduras organized by the Colectiva de Mujeres Hondureñas (CODEMUH), October 2004.

especially attractive for factories that are currently unionised. This potential is already seen in areas such as Mae Sot, where there are over 100,000 Burmese migrant workers, and where no unions have been established (see Arnold and Hewison, 2005).

In pursuing an FTA with the US, Thailand (like other developing countries also seeking FTAs) must take steps to shift into capital-intensive, higher value-added production. This requires a significant transfer of technology. The problem is that the technology usually comes associated with FDI by foreign TNCs, but FTAs may limit this. For example, Article 15.8 of the USSFTA prohibits Parties from imposing: (a) export requirements; (b) local content requirements; (c) the purchase of or provision of preference to local goods or services requirement; (d) net foreign exchange generation (that is, tying import value/volume to export value/volume); (f) transfer of technology, production process, or other proprietary knowledge requirements; and (g) any requirement that goods or services to a specific regional or global market be supplied exclusively from the territory or Party. Among these stipulations in the USSFTA, points (a) through (d) are covered by Trade Related Investment Measures under the WTO, but points (f) and (g) are not; typically, FTA provisions go beyond WTO requirements. It is clear that these provisions, if applied to the Thailand-US FTA, will limit the potential for access to higher-level technology.

Again, however, the Thai government is selling this FTA to the Thai public as a golden road to development while failing to mention the massive amounts of investment required to reach the technological and infrastructure development levels necessary to take advantage of an FTA with the US. Given the extreme levels of competition globally, US and other corporations, including Asian TNCs using Southeast Asia as an export base to the US and other markets, will not automatically transfer technology to local manufacturers. For the past two decades Thailand and a number of other nations have been slow to acquire technology, management and labour skills necessary for capital-intensive manufacturing. This has been due to a lack of government investment and initiatives, and a low absorptive capacity of domestic companies, including suppliers to TNCs (see Mirza, 2002). In Thailand the lack of backward and forward linkages in industry has also contributed to the lack of transfer and diffusion of technology. At the same time, because research and development is usually based in each TNC's home country, the highest value-added production processes usually also remain home. In short, if applied to the Thailand-US FTA, Article 15.8 of the USSFTA ensures that the transfer and diffusion of technology is fraught with difficulties, and given Mexico's negative experience with NAFTA, technology transfer may have limited prospects.

Also drawing on Mexico's experience, it is worth observing that the Thai-US FTA has a potentially huge impact on Thailand's agriculture, in addition to state owned enterprises, services, telecommunication and e-commerce, the financial sector, intellectual property rights, investment, and the environment. Under the template of the USSFTA, the negative impacts are likely to considerably outweigh the positive results from increases in trade with the US. Although FDI as a result of the FTA is projected to increase, including from third party nations that wish to use Thailand as a manufacturing or export base to the US for select goods, the chances are high that a Thailand-US FTA would not only be detrimental to the Thai economy and workers in the manufacturing sector, but also for Southeast Asia as a whole. This is because it could fragment the ASEAN process that has stressed its critical mass as a region of

500 million people in closely co-operating economies, rather than a set of individualist economies pursuing self-interest in competition with one another. Indeed, it can be argued that both Singapore and Thailand are in the process of significantly weakening this regional solidarity and the potential economic force that could be the Southeast Asia region's best chance to weather the current and inhospitable global economy driven by corporations' desire for liberalised markets, flexible labour, and increased profits.

## **CONCLUDING COMMENTS**

It is clear that increased competition and the economic hegemony of huge global corporations has confronted labour and people's movements around the world. They are often inadvertently and perhaps inevitably forced into defensive positions as national economies are negatively affected by the course of globalisation and investment in the global economy. Nations are increasingly competing with one another for FDI and employment, and workers and the people at the bottom of the global system of markets and production are often unable to see beyond the immediate threats to jobs, livelihoods, and survival. One of the points of this paper has been to stress that it is increasingly necessary for workers across the globe to understand that their futures are increasingly interwoven. The increasing ease of corporations' unrestrained ability to scour the globe for cheap labour and profits cannot be effectively confronted solely through nationalist or inward-looking strategies. Southeast Asia's regional potential is being fragmented by bilateral FTAs. Despite arguments made by participating governments that FTAs are win-win arrangements, unprecedented global competition for markets, FDI and ever-cheaper production is not sustainable for many developing economies, yet it is exactly what corporations need. Making matters worse, as the case of Mexico has shown, free trade, increased market integration, and FTAs are more compatible with authoritarian labour control, increased poverty, job displacement, and weakening of the development process than with sustainable development.

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