

Executive Summary (version of Dec 2014)

ASEAN's economic integration model: a conceptual approach

Jacques PELKMANS

Understanding ASEAN's economic integration model is a genuine challenge. A fundamental reason why conceptual difficulties arise in the case of the ASEAN Economic Community (=AEC) is that ASEAN architects observe two stylized (regional) economic integration approaches in the world which they do *not* want to pursue : the 'EU model', which is supranational, far too ambitious and also to a degree 'open-ended' in terms of further ambitions ; and the classical free trade area (= FTA) approach, even when upgraded a little nowadays. The AEC is based on two concepts, presented as 'parallel : the 'single market' and (ASEAN as a) 'production base' for segments of global value chains. These two instruments have to be understood in the light of what matters most to ASEAN: the medium or long-run growth prospect for the region. Thus, if the production base is expected to be growth-enhancing in a powerful way (as experience in East Asia suggests), the single market as a 'concept' may well be downgraded in actual practice. Since global value chains thrive on 'openness' of economies and easy market access (in particular, in East Asia), market access in East Asia via FTAs might rank as high or higher for the success of the ASEAN production base than the pursuit of an ever deeper – indeed, 'single' - internal ASEAN market. The present monograph will focus on the ASEAN economic integration logic from a conceptual point of view, but the intricate and multi-fold linkages with measures relevant for ASEAN as a 'production base' have explicitly been addressed as well.

The present contribution to the ASEAN-Integration-through-Law project aims to scrutinize the concepts, logic, sequencing, coherence and options for the 2015 AEC. The author assumes an economic perspective, whilst taking due account of institutional, legal and political economy aspects. Economic integration processes largely take place in markets. Nevertheless, a political desire to pursue (ever) 'deeper' economic integration requires (ever) more demanding regulatory, economic policy, political and institutional as well as legal commitments by participating countries. This is bound to extend decision-making from trade (and 'ASEAN') ministers to broader government policies and reforms of standing economic regulation practices. Assuring 'deeper' economic integration is therefore very different in nature than fixing a classical FTA.

The AEC combines two concepts, the "ASEAN Single Market" (which is likely to grow into its own sui generis notion of deeper market integration) and ASEAN as a "production base" for world multinationals as well as for ASEAN business itself (the latter is a most unclear concept, even when carefully checking the ASEAN Blueprint / Roadmap with some 300 items of concrete measures and milestones). The underlying strategic economic aim that unites all ASEAN countries is rapid and steady development, underpinned by long-term economic

growth and an acceptance of gradual structural change. The monograph takes a systematic look at these 'concepts', starting from the fundamentals of economic integration - which also matter for ASEAN - , ASEAN's four strategic choices about what FTA-plus to opt for (these choices are illustrated in a comparison with NAFTA), the economic rationale of the AEC, the Bali Vision and a scrutiny of the five instrumental economic concepts (free flows, Single ASEAN Market, ASEAN as production base, equitable development and its economic competitiveness). The economic rationale is developed for two stylized scenarios : a cooperative ASEAN-led development strategy and a pro-competitive single-market-minus serving development. This conceptual and economic foundation is followed by a careful summary of and commentary on the entire AEC Roadmap. Subsequently, this analysis is deepened for the first three of these five instrumental concepts by scrutinizing the substance of the commitments in the Roadmap in considerable depth, including progress to date. Interestingly, even though the Roadmap became publicly available only in 2009, one can already discern many instances where ASEAN has deepened its commitments and/or made progress beyond what was originally drafted. The AEC has clearly stimulated strategic thinking in ASEAN Member States and prompted policy action over a wide front of policy domains. However, in a conceptual approach, such 'good news' is less important than the verification of whether ASEAN is living up to the conceptual requirements of what a single market and/or (ASEAN as a) production base is or will be. The analysis of the progress towards a Single Market is easier in this respect, not only because the conceptual analysis is helped by a six-stages theory of market integration developed in Section 2.2 - comprising two high stages akin to a Single Market - but also because of the instrumental economic concepts emphasized by ASEAN itself (in particular, the 'free flows'). Our conclusion is that ASEAN will not enjoy free flows, when studying today's calendars and follow-up commitments, but it is not excluded that - with some delay beyond 2015 - a quasi-single-market might eventually develop. The current plans are, more often than not, ambivalent and the history of ASEAN as well as its 'allergy' for even the slightest forms of centralization or common regulation/harmonization does not sit comfortably with the requirement that ASEAN is ready to develop the 'positive integration' to make that quasi-single-market function properly and the free flows truly free.

In goods markets, a number of weaknesses has survived in ATIGA and need to be addressed. Far worse, the issue of 'core NTMs' and the removal or reduction of TBTs, already around for a long time, have not even begun to be taken serious ten years after Bali. In services, there are a number of inconsistencies and uncertainties ; when zooming in on subdomains, one inevitably finds loose ends and 'flexibilities' (i.e. national restrictions can be retained) ; the area of network industries' services is dealt with insufficiently and without much conviction, whereas transport protectionism inside ASEAN would seem to prevent much progress. In financial services, very little had happened - not surprising given the soft text in the Roadmap - but the year 2013 suddenly brought to the surface a most ambitious and well-thought out strategy of financial market integration, together with the pursuit of an ASEAN capital market and solutions for demanding problems of financial stability in such a single market. However, the strategy for financial market integration is so ambitious that it would appear far out of bounds for the routine commitments of ASEAN even with the

greater acceptance of common measures in the AEC. In investment, there is still no routine commitment to accept 100 per cent equity for foreign investors, although the production base idea strongly suggests that one wishes to attract precisely world-class foreign investors. The free flow of skilled labour is highly conditional and carefully separated from the MRAs for professional services.

Our analysis has not traced anywhere an operational definition of ASEAN as a production base. Moreover, many quasi-single-market measures also appear to serve, actually or potentially, the notion of this production base. However, a good deal of measures of the production base tends to be national, ranging from the business and investment climate to education, infrastructure (both domestic and cross-border), technical infrastructure for testing, standards, repairs and more generally the absorption of technology (which in turn hinges on high quality education), and policies such as competition policy and consumer protection. It extends to the actual conduct of the customs for business, long a concern in ASEAN. We undertake an attempt to exploit the recent empirical economics of global value chains to formulate an economic rationale for the production base approach by ASEAN and it turns out to be a most interesting argument, further strengthened by the determination of middle-income ASEAN countries to escape the 'middle income trap'.

We attempt to provide critical ingredients for an ASEAN strategy underpinning the AEC, as this seems to be lacking, an omission likely to severely hinder future developments. Apart from the four strategic choices when building an AEC (see before), we also compare the substance of NAFTA with the expected substance of the AEC (and the EU single market as a contrast). This detailed comparison helps one to appreciate the concrete implications of the present AEC design and hopefully clarifies the need for a well-thought-out AEC strategy. ASEAN does not have to copy NAFTA and it can also go beyond it but it must identify consistent and workable alternatives in any event. The two economic scenarios set out in section 2.5 indicate the beginnings of such a strategic reflection.

Three options are distinguished subsequently. One is the AEC as a single-market-minus, a very demanding but attractive option, not least because a lot of what is implied in this option would also be useful for the production base. A second is ASEAN as a production base. However, how much "ASEAN" this really is remains unclear: ASEAN's production base is much more interesting as part of 'factory Asia' if deep FTAs with East Asia and some other trading partners can be concluded jointly for ASEAN as a single group. Nevertheless, the success of the production base for ASEAN's economic development hinges on a non-AEC property: the capability of individual ASEAN countries to develop backward and forward linkages with the local economy. The third one is really a symbiosis between the former two, not least in the light of the pressures emerging from the catch-up growth of two giants in the region: India and China. Such a symbiosis is not easily leading to coherence and consistency but this may improve over time, as before with AFTA. Indeed, time is a friend of coherence and deepening. One should regard the symbiosis as a 'living compact' for purposes of market integration and development, complemented by a range of national policies, often emulated

between the ASEAN countries. In this sense, the Bali Vision may be rationalized after all and its more mature version might eventually vindicate.