

**ASEAN Economic Cooperation and Integration:
Progress, Challenges and Future Direction**

Chia Siow Yue,
Singapore Institute of International Affairs
and
Michael G. Plummer,
The Johns Hopkins University, SAIS and East-West Center

ASEAN economic cooperation and integration have come a long way since the organization's early days, when cooperation was more political and diplomatic than economic in nature. Beginning with the ASEAN Free-trade Area (AFTA) in 1992, ASEAN economic cooperation has become increasingly prominent, and in the 21st Century it represents an integral part of the regional economic landscape.

The ASEAN Economic Community (AEC) initiative, conceived in 2003 and officially launched in 2007, constitutes by far the most ambitious attempt by ASEAN Member States to create a "unified market and production base" and envisions arguably the deepest economic cooperation program in the developing world. Its goal is to allow free flow of goods, services, foreign direct investment (FDI), and skilled labour, and freer flow of capital within the region, to be accomplished by 2015 (2020 for the transitional ASEAN economies). The AEC is being implemented in the context of a rapidly-changing global and regional architecture, with multilateral trade negotiations on hold and "mega-regional" trade pacts in negotiation, including the Trans-pacific Partnership (TPP) and the Regional Economic Comprehensive Partnership (RCEP), the latter being a manifestation of "ASEAN Centrality". The stakes associated with the successful construction of the AEC are clearly very high for ASEAN and its Member States.

The goal of this monograph is give a contextual review of ASEAN economic cooperation in general and the AEC in particular, analyse its economic implications, assess its implementation to date, and consider future challenges. Below we summarize some of the major findings.

In terms of the potential economic benefits from the AEC, the literature underscores several key benefits of economic integration, including an enlarged market with economies of scale and scope, improved resource allocation with free movement of factors of production, improved resource pools with inflows of capital and labour, and competition leading to improved efficiency and innovation. In an earlier study (Plummer and China 2009), we assess the benefits of the AEC to various ASEAN stakeholders (government, business, labour, consumers) as stemming from:

**Benefits from Liberalisation of Trade in Goods and Services*, with a single market and production base allowing ASEAN to benefit from economies of scale and efficiency in production network processes, boost competitiveness, strengthen ASEAN institutions, and improve the region's socio-economic environment. The elimination of intra-ASEAN tariffs and non-tariff barriers will boost intra-ASEAN trade and in the process have positive effects on economic growth and employment, result in more efficient allocation of resources and thus gains in productivity, encouraging foreign and domestic investments, lower business costs, increase economic competitiveness, and lower consumer prices and widen consumer choice. Liberalisation of the services sector is particularly important, given its rising contribution to output and employment in the region, relevance to value chains, and relatively high *status quo* barriers. In addition, addressing behind-the-border measures such as those related to competition policy and intellectual property rights (IPR) protection, as well as infrastructure and spatial connectivity, should yield substantial gains.

***Benefits from Liberalisation of Investment and Skilled Labour Flows**, with greater FDI inflows bringing in financial resources for fixed investment as well as technological and managerial knowhow, participation in regional production networks and global supply chains, resulting in improved efficiency in production and marketing. The ASEAN Comprehensive Investment Area (ACIA), which began implementation in 2012, should lead this process; it is comprised of four components of FDI liberalisation, facilitation, promotion and protection. In addition, skilled labour mobility (including professionals) is essential for effective implementation of services liberalisation and FDI liberalisation as well as for deeper economic integration. A free flow of skilled labour will increase ASEAN's attraction to foreign MNCs, particularly as it meets their need for intra-corporate transferees of management and technical personnel. The easier movement of ASEAN professionals within the region will facilitate people-to-people contact and enable transfers of knowhow, experiences and best practices.

***Financial and Capital Market Development**, with more efficient markets to finance trade, investment and corporate development in ASEAN countries. Cooperation in ASEAN and in ASEAN+3 (that is, including also China, Japan and South Korea) have resulted in several financial initiatives such as Chiang Mai Initiative Multilateralised, Asian Bond Market, and Regional Surveillance Mechanism.

***Narrowing the Development Gap**, with Cambodia, Lao PDR, Myanmar and Vietnam (CLMV) beginning to catch-up with the more advanced ASEAN Member States. As detailed at length in this study ASEAN economies are characterised by wide economic diversity in factor endowments, economic structures and levels of economic development. It is generally accepted that a wide development gap would lead to negative spill-over effects between rich and poor neighbourhoods as well as hindering consensus building and the speed of progress towards the ASEAN Economic Community. The Initiative for ASEAN Integration (IAI) is the key policy instrument to provide economic and technical development assistance to the CLMV countries, embodying also the transfer of knowhow, development experience and best practices from the more advanced ASEAN Member States. Moreover, regional production networks hold great promise in plugging in CLMV productive factors into the global and regional economies; hence, the anticipated boost to these networks via the AEC should benefit significantly ASEAN's poorest members.

While it is difficult to put numbers to the potential economic effects of the AEC, our earlier study uses a Computable General Equilibrium (CGE) model to gauge the effects assuming complete elimination of tariffs and NTBs, liberalisation of five service sectors, AEC-induced changes in FDI and a 5 per cent reduction in trade costs. Despite the fact some of the most important benefits of the AEC are not included in the simulated scenarios (e.g., competition policy, greater IPR protection, financial cooperation, other behind-the border measures), the study estimates that the increase in economic welfare should be 5.3 per cent or US\$69 billion relative to the baseline, that is, more than 6 times the effect estimated for AFTA. All ASEAN countries benefit.

Hence, the potential gains are large. Nevertheless, implementation of such an ambitious program in the context of such a diverse region is difficult. The "ASEAN Scorecard," an implementation tracking mechanism undertaken by the ASEAN Secretariat, attempts to gauge annual progress in meeting the exigencies of the AEC Blueprint. In essence, ASEAN countries have thus far fully implemented commitments related to freer flow of capital (except Myanmar), free flow of skilled labour, priority integration sectors, competition policy, mineral, ICT, taxation (except Cambodia), and e-commerce. Moreover, all ASEAN countries have more than half implemented free flow of goods, free flow of services, free flow of investments, food-agriculture-forestry, consumer protection, transport, energy,

IAI and external economic relations. However, the compliance record is mixed. Much remains to be done if the AEC is to be completed on schedule.

In sum, ASEAN economic cooperation and integration have come a long way. From a set of token cooperative initiatives during its first few decades to a “single market and production base” in the form of the AEC, ASEAN now can boast an increasingly-integrated region with a clear plan for deepening integration in the future. The progressively outward-oriented nature of the trade and investment regimes of ASEAN member economies is consistent with the direction of the AEC and related initiatives, which stress the need for “open regionalism” more than most other regional economic groupings. No doubt this reflects the fact that the lion’s share of ASEAN’s trade and investment interaction is extra-regional. But it also is an expression of ASEAN’s development strategy, one that would well be imitated by the many other regional economic groupings sprouting up throughout the world.

Outward orientation has served ASEAN well. It has been one of the fastest growing regions in the world for the past quarter century, with a major downturn only during the Asian Financial Crisis of 1997-98. While there is considerable variance in performance across ASEAN countries, per capita income on average has been rising robustly, poverty rates have been falling, and social indicators have been improving. Although the US Financial Crisis of 2008-2009 and the on-going Eurozone Sovereign Debt Crisis have affected ASEAN growth over the past five years due to their exposure to global markets, liberal trade and investment regimes have allowed them to bounce back quickly, helped in part by buoyant commodity demand (until recently) by China and India for the resource-rich ASEAN economies.

We show in this study that the AEC has made substantive progress in implementing measures outlined in the AEC Blueprint and in subsequent initiatives such as ASEAN infrastructure connectivity. But much more remains to be done. Indeed, the implementation rate has been slowing down, rather than rising as it will need to do to meet the rapidly-approaching deadline of 2015. As some of the more difficult issues remain, it will take a good deal of political momentum at the highest levels to ensure a successful outcome.

But the timing is less significant than the final product. The EU Single Market Programme, dubbed “EC 1992” due to the fact that it was intended to be completed at the end of 1992, had only half of its ambitious policy agenda in place by then and just over three-fourths by the end of 1994. But the markets continued to respond positively to the initiative, as they saw so much progress (when there was so much pessimism to start). Today, the Single Market Programme is considered a great success (certainly not to be confused with issues associated with monetary union). Likewise, ASEAN should keep its “eye on the prize”: a single market and production base. Hopefully this can be done by 2015; but what needs to take priority is getting it right, rather than getting it done on time.

Finally, given the rapidly-changing regional economic architecture, ASEAN will need to play an active, contributing role to advance its interests. ASEAN leaders realise this. For example, in November 2012, ASEAN and six of its FTA partners launched the Regional Comprehensive Econsership (RCEP) initiative, which is to create a “flexible” FTA with negotiations beginning early in 2013 and concluding in 2015. The RCEP is an ASEAN initiative, a concrete manifestation of “ASEAN Centrality”. With some ASEAN members being part of the on-going TPP negotiations while others are not, the RCEP will serve to unite ASEAN under the Asian-FTA track.

In sum, ASEAN has come a long way, but still has a long way to go, with many exciting prospects as well as challenges) that await.