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AEC 2015: A model for Asia-wide regional integration?

Bruno Jetin and Mia Mikic

Introduction

Much research and media attention is focused on the progress of regional integration among Southeast Asian countries.¹ Back in 1967, five of them formed Association of Southeast Nations (ASEAN) and by 1999 the group was completed with ten ASEAN Member States (AMS): Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Thailand, Singapore and Viet Nam. Only one country from this sub-region is currently not a member to ASEAN, however, Timor-Leste formally applied to accede in 2011.

While ASEAN had been labeled as a political association at the time of its founding, it slowly but certainly developed interest in economic aspects of integration. Most prominently, since the establishment of ASEAN Free Trade Area (AFTA) back in 1992, much of the integration process revolved around economic and trade issues. ASEAN financial crisis and its impact on Asian countries contributed to AMS's realization of the need for a tighter regional entity to allow building more resilient economies. Thus it was not surprising to see the proclamation of ASEAN 2020 announced in 1997. Likewise, political and economic dynamics in the region and globally were aligned with the ideas of ASEAN leaders meeting at the 9th Summit in 2003 to call for the ASEAN Community. Ultimately, this goal was advanced to be implemented in 2015 through the establishment of the ASEAN Economic Community (AEC) at the 12th ASEAN Summit in 2007. The other two communities: ASEAN Political-Security Community and ASEAN Socio-Cultural Community are still planned for full implementation at a later stage.

The AEC Blueprint was developed in 2007 to provide a roadmap for government entities involved in AEC implementation. It has four pillars driving a transformation of ASEAN into a single market and production base, a highly competitive economic region of equitable economic development, and a region that is fully integrated into the global economy by the end of 2015. Each of the four pillars presents a demanding set of challenges - with numerous individual actions to be taken by AMS by the end of December 2015 and for the full realization of the AEC. In order to assist AMS in monitoring progress along the roadmap, ASEAN has introduced so-called the AEC Scorecard, a self-assessment mechanism, tracking progress of each AMS in each pillar. Original unwillingness to reveal publicly individual AMS scores has weakened but not disappeared, thus public still has no access to the most recent status. Based on the data available for 2012 scorecard, ASEAN is reaching only 82% of its final target in early 2015 so a big push will be necessary to improve this by the end of 2015. While some AMS are better positioned than others in terms of ticking items off the scorecard,² the actual progress will occur only when there is a critical mass of institutions to enforce these legal and regulative measures. At present, many challenges still remain at the implementation level of each pillar.

This book “AEC 2015: A model for Asia-wide regional integration?” brings together scholars and researchers who have been studying ASEAN from close by or from a distance to provide their assessment of the AEC process and progress from a perspective of wider regional integration. While it was not possible to obtain a contribution for every aspect of the AEC process, we have tried to cover most important areas or those that are most relevant for the rest of Asia and globally either in terms of impacts or in terms of valuable lessons and practices which could be leaned on by those who are pursuing any type of regional integration. In what follows we provide the brief summary of the chapters. As AEC pillars themselves are not perfectly balanced in terms of areas they cover and policies they refer to in

the blueprint, while not being fully independent of each other, this book is also slightly asymmetric with a bit more focus on pillars 1, 3 and 4. Chapters, however, often provide opportunity to a reader to make connections between the pillars and also over time of integration process. The summary of chapters is provided below under the headings of three parts of the book for ease of reference.

Part I - ASEAN economic integration in the context of East Asia regionalism

All reliable indicators show that the ASEAN Economic Community (AEC) will not be fully completed by its 2015 deadline. David Martin Jones in chapter 1 asks if this outcome does not test the limit of ASEAN's guiding propositions and cooperative practices – non-interference principle and consensus building, and non-confrontational bargaining – and their efficacy in integrating AMS's economies and facilitating its wider regional economic integration. In the past, these principles and practices were sufficient to achieve the main outcome to be credited to ASEAN: the achievement, until recently, of regional security and political stability. This was a necessary condition for the success of export-oriented growth and attraction of foreign investment. But a single market and production base requires that all AMS have a common interest and accept a higher degree of cooperation. This is probably what is lacking because the political elite of each AMS grants the monopoly of decisive domestic sectors to the economic elite and their interest are so intertwined that they will not accept easily the direct competition of neighboring firms. Jones also discussed what he calls the “sinification of the ASEAN way” and how it has also profoundly changed the capacity of ASEAN to deepen its integration. ASEAN's connectivity master plan will be funded in great part directly or indirectly by China to the extent that these new infrastructures serve Chinese interests which are not necessarily those of ASEAN. Worse, ASEAN capacity to provide

regional security may be endangered by China's attempt to establish its domination over the South China Sea. The rise of China and the response of the other big powers in the region - the USA, Japan, India and Australia- raise far more critical issues than the AEC can resolve. These issues are analyzed in deeper details by the following chapters of the book.

Jean Raphaël Chaponnière and Marc Lautier also question the nature of ASEAN regional economic integration process in Chapter 2. They recall the creation of ASEAN in 1967, after several failed attempts, to be associated with the perception of rising communist threat. Twenty five years later, ASEAN launched AFTA whose objective was not to promote intra-regional trade but to enhance ASEAN countries' attractiveness for FDI. ASEAN countries have reduced trade barriers and made significant progress towards a de jure integration, while the process of de facto integration launched by the relocation of Japanese manufacturing firms in the mid-eighties continued. If one excludes intra-firm transactions and exports from free trade zones, AFTA would explain only one fifth of the intra-regional trade. ASEAN members are now involved in two mega-regional agreements; one with a potential to protect ASEAN centrality, ASEAN+6 or Regional Comprehensive Economic Partnership (RCEP) and another, the US-led Trans-Pacific-Partnership Agreement.

In Chapter 3 Mia Mikic addresses the issues stipulated under AEC pillar 4 seeking deeper integration of ASEAN into the global economy with emphasis on ASEAN centrality and improved coherence of various agreements that may impact the operation of AEC. As of now, it appears that RCEP might be the chosen path towards seeking a necessary consolidation of all existing ASEAN's trade agreements. This will succeed only if RCEP evolves into a high-standard trade agreement and allows for rationalization of existing deals. Upon providing current FTA landscape in Asia, this chapter examines the possible effects of the RCEP on trade not only of ASEAN+6 but also other Asian countries, taking into account

the fact that all of the negotiating countries of the RCEP are already participants in other trade agreements, under implementation or under active negotiations.

Chapter 4 by Prema-chandra Athukorala examines emerging global production sharing (GPS) and trade patterns in light of the experiences of ASEAN countries which have been major and successful participants in GPS. 'Network products' (parts and components, and final assembly traded within production networks) constitute almost 2/3 of the merchandise exports of Singapore, Malaysia, and the Philippines, almost half those of Thailand, and a smaller but still significant share for Indonesia. GPS has certainly strengthened economic interdependence among ASEAN countries, and between them and China and the other major economies in East Asia, but this has not lessened the dependence on the global economy. The operation of the regional cross-border production networks depends inexorably on trade in final goods with the rest of the world. There is no evidence to suggest that forming RCEP would help them to enhance gains from the ongoing process of GPS fragmentation while reducing the dependence on the Western markets. GPS strengthen the case for unilateral and/or multilateral approach to trade reforms.

The ASEAN countries have experimented contrasted exchange rate regimes since the 1990s. The financial crisis of 2008 has given new interest to the question of monetary cooperation at the regional level. In Chapter 5, Jacques Mazier, Myonung Keun On and Nabil Aflik use a Fundamental Equilibrium Exchange Rate (FEER) approach, to estimate exchange rate misalignments and linked them to the external performances and growth of East Asian countries. They find that exchange rate misalignments are more limited in the current period than in the 1990s, in clear contrast with what is observed between European Union countries. The economic consequences of alternative exchange rate regimes in East Asia are examined using a four- country stock flow consistent model of East Asia. The configuration of the

1990s and 2010s can be compared and alternative scenarios for the future of ASEAN integration are discussed.

Exploring further the exchange rates issues, Witada Anukoonwattaka connects those with the presence of GVCs in Chapter 6. The growing GVCs has changed ASEAN from exporting final goods to intermediates, and from exporting directly to advanced markets to exporting via downstream countries, particularly China. This chapter looks at how an analytical framework for evaluating the impacts of exchange rates on export competitiveness has been changed by the GVC phenomenon. Findings imply that entering to GVCs make a country prone to a change in the exchange rate of other countries even if they are not their direct trading partners. There seems to be compensating impacts on trade volume and trade product range. The net impact then becomes ambiguous and sector- and country- specific. For instance, a currency depreciation of Yuan might reduce export product range from ASEAN, but export volume of each product remaining might increase.

Last chapter of Part I, Chapter 7 by Yann Duval and Emilie Feyler takes stock of the progress made by ASEAN countries in reducing intra- and extra-regional trade costs using various cross-country indicators of trade facilitation performance and a new bilateral trade cost dataset developed by ESCAP and the World Bank. Despite significant improvements over time, trade costs other than tariffs among ASEAN members remain relatively high, with in particular a wide performance gap between Cambodia-Lao PDR-Myanmar and other ASEAN members. ASEAN has lower trade costs with North-East Asia than with itself. Southeast Asian economies under the ASEAN Economic Community would benefit from further intensifying trade facilitation reform, among themselves but also with other Asian regions, keeping in mind that emphasis may best be placed on completing implementation of the many signed but often delayed intra-ASEAN agreements.

Part II - Impact of regional integration on structural change, employment and inequalities

Using the fact that trade integration is a cornerstone of the ASEAN Economic Community, Kee Kim Beom, Fan Zhai and Phu Huyuh set to review the structural changes that have taken place in the past decades in ASEAN Member States in Chapter 8. They use an innovative computable general equilibrium model to assess the impact of ASEAN trade integration on labour markets. The results show that trade liberalization contributes to sizeable increases in output and employment in ASEAN Member States, but that the benefits tend to vary by country, sectors, and gender. The mixed distributional effects point to the need for concerted employment and labour market policies, including improving access to education and training for vulnerable groups, strengthening the quality, coverage and sustainability of social protection systems and monitoring and managing the gender impacts of ASEAN trade integration

Francis Cripps and Naret Khurasee in turn use a macro model based on historical series for the past four decades in Chapter 9 to project trade and GDP of ASEAN countries up to 2030 and confront the outcomes with trends in population structure and employment under different assumptions about policies in member countries. The projections imply that gaps in living standards will remain wide but suggest that exchange rate management, competition policy, agricultural policy and targeted government services and infrastructure could promote more inclusive growth and provide wider opportunities for provincial and rural populations left behind by export-led industrialization and services concentrated in large cities. In the context of the ASEAN Economic Community such policies may require closer coordination than hitherto.

Outsourcing can be loosely defined as the extent to which production activities are contracted out at arm's length, as opposed to being performed in-house. In the context of

ASEAN, outsourcing has by and large been a catalyst of impressive economic growth, yet the thorough understanding of this issue remains limited. In Chapter 10 Aekapol Chongvilaivan explores the implications of burgeoning outsourcing activities in ASEAN on labor market development, namely the effects on labor productivity and skill premium. The findings from this analysis yield policy implications regarding how to utilize regional production networks as the impetus for labor development.

Chapter 11 by Teemu Puutio draws attention to the importance of creative economy for ASEAN. ASEAN has adopted a soft-regionalism approach to its regional integration efforts, preferring flexibility, non-interventionism and consensus based decision-making over sovereignty transfers. As a result, the regional creative economy persists to resemble a loosely knit patchwork of disparate national regimes for creativity and innovation that interact only sporadically through non-ASEAN led developments such as supply chains. Without decisive and centralized actions to harmonize institutions and bridge the resource and capability gaps, the creative economies of members with weak creative capacities and institutions will be foreshadowed by those of which have more sophisticated labor forces, stronger enabling legal frameworks and a more comprehensive network of supportive institutions. Consequently, weaker members may find themselves in “low-technology and creativity traps” with diminishing prospects of taking the next step upward.

Part III - Impact of regional integration on poverty, inequalities and social cohesion

Turning to addressing issues under AEC pillar 3, Marc Lautier’s Chapter 12 examines social cohesion, economic resilience and prospects for long-term growth. While structural change has been the main engine of long-term catching-up processes, it increases the

vulnerability of an economy to shocks. The domestic aptitude to adjust to shocks and to minimize growth losses is a major factor of development performance. Economic resilience depends mainly on social cohesion and State's effectiveness. Specific indicators for these two notions are provided for a large sample of developing countries. The comparative analysis demonstrates that, while Southeast Asian economies are a diverse group, most of them have a strong ability to sustain growth for long periods of time. As for development institutions and growth performances, the proximity between Southeast and East Asia is much stronger than between Southeast Asia and the rest of the developing world.

Bruno Jetin reminds that The AEC is committed to poverty reduction and the wellbeing of its people thanks to inclusive growth and equitable access to opportunity of human development. He assesses such a claim in chapter 13 through the lens of social cohesion. A society is socially cohesive when it combines three components: a low social exclusion, and a high level of trust and mobility. After a review of the long-term evolution of between and within- country inequality, he examines the recent evolution of absolute and relative poverty in ASEAN countries. He then maps social cohesion in ASEAN according to its three components, namely exclusion, social capital, and social mobility. It appears that convergence between ASEAN countries is recent and limited and that within-country inequality is high and sometimes growing. Relative poverty has substituted absolute poverty in some countries putting social cohesion at risk. His chapter concludes by delineating some country member profiles of social cohesion.

Natalie Fau in turn examines the role of infrastructural investment in reducing inequalities. According to ASEAN leaders, improved connectivity, especially through transport links, is an essential condition for economic growth in Southeast Asia. Furthermore, the upgrading and the construction of infrastructure and the harmonization of the regulatory framework would significantly narrow the development gap within ASEAN. It is precisely

this hypothesis that chapter 14 is questioning, by focusing especially on the Master Plan on ASEAN Connectivity (MPAC) development projects for land (road and rail) and sea transport infrastructures. After presenting the main directions taken by the MPAC and the tools used to decrease territorial inequalities regarding provision of infrastructures, this paper attempts to assess on different scales (regional, sub-regional and local) the regions that have gained or lost since the MPAC was implemented and to explain the reasons for these disparities.

The last chapter of Part III contributed by Christine Cabasset focuses on the relationship between local governance and inequality. Indonesia has considerably improved its economic and socio-economic performance at the national level, especially since the 1997 Asian financial crisis. However, some internal weaknesses are obstacles for the country to achieve real leadership in Southeast Asia and beyond. Spatial and social inequality not only subsists, it has increased since 2003, particularly within provinces, within districts and within urban as rural areas. This rise exposes the archipelago to social risk at all administrative levels, including in the “wealthiest” provinces. Chapter 15 highlights some of the main factors explaining the difficulty national and local governance have to tackle poverty and inequality issue.

The Concluding chapter proposes that the 2015 deadline for the establishment of AEC should only be seen as one more milestone on the long journey towards an objective of deep economic integration not commonly found among developing countries in Asia. It definitely should not be seen as a final destination, because numerous challenges remain. Enforcement of the AEC accord will require changes to domestic laws or even national constitutions. These would be considerable challenges for ASEAN member states beyond 2015. One of them is to maintain the purpose and centrality of ASEAN in Asia. During decades ASEAN has been the sole purely Asian regional institution where not only Southeast Asia countries

but also the other big Asian players of the region (Japan, China, India and South Korea) could meet, agree and take initiatives in the fields of trade and finance. These big powers could not often engage directly due to political discontent and rivalry, and ASEAN was the place where they could meet and negotiate. ASEAN, a shallow institution, was for want of anything better, was pivotal for Asia-wide integration. With the new round of negotiation of the RCEP and the one for the Free Trade Area of the Asia-Pacific (FTAAP) initiated in November 2014 at the APEC summit in Beijing, the big powers start negotiating directly calling into question the centrality of ASEAN and its future *raison d'être*.

¹ Google reports about 1,330,000 results to the term “ASEAM Economic Community” on 14 April 2015.

² For instance, recent political changes in Thailand resulted in much smoother and faster of process of transforming AEC policies and measures into domestic laws, as a first but necessary step of implementing AEC.