

Research Focus

Building an ASEAN Economic Community: From Vision to Reality

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At the 2003 ASEAN Summit in Bali, Indonesia, ASEAN leaders agreed to embark on a bold and ambitious initiative to integrate their economies and establish an ASEAN Economic Community (AEC) by 2020. This was later brought forward by five years to 2015 at the ASEAN Summit in Cebu, Philippines in January 2007. The AEC initiative will involve achieving a higher level of regional economic integration than what exists today in ASEAN.

A 2003 McKinsey study had found that ASEAN had lost its competitive edge to China and other emerging economies, and stood to lose substantial foreign direct investment (FDI). This became even more evident in recent years as China overtook ASEAN as the developing world's top location for FDI; international production networks have increasingly been reconfigured to take account of China's rapid economic expansion and industrialisation. India has also become a major provider of services such as information and communications technology (ICT) and is strengthening its manufacturing capabilities. Such developments will have serious repercussions on ASEAN's economic well-being over the longer term if ASEAN remains uncompetitive. Moreover, the rise of China and India as potential economic superpowers may redefine regionalism in Asia and in the process reduce the significance of ASEAN as a regional player.

Facing such challenges, the launch of the ASEAN Charter and the AEC blueprint at the November 2007 ASEAN Summit in Singapore

occurred at a propitious time. The AEC blueprint provides the necessary roadmap to accelerate economic integration and realise the AEC by 2015. This includes action plans, targets and timelines for implementing specific economic measures to move the AEC process forward. The ASEAN Charter represents the legal personality and more formal rules-based institutional structure ASEAN needs.

The ultimate objective of the AEC is to create a single market and production base where goods, services, investment, capital and skilled labour will move freely. ASEAN has identified 12 priority sectors earmarked for fast-track integration: electronics, information and communications technology (ICT), healthcare, wood-based products, automobiles, rubber-based products, textiles and apparels, agro-based products, fisheries, air travel, tourism and logistics. If the AEC initiative succeeds, an integrated ASEAN market of over 500 million consumers with a combined GDP of US\$1 trillion would undoubtedly be a lucrative place for multinational corporations to set up shop and do business.

Conceptually, the AEC connotes a European Union (EU)-style single market. Peter Lloyd of the University of Melbourne accepts that the objective of a single market is very strict and definite, and that it will require coverage of all measures to remove discrimination against ASEAN suppliers of goods, services and factors. In this context, Professor Lloyd finds that ASEAN still has a long way to go to

achieve this type of integrated market. Indeed, his findings indicate that achieving a European-style single market seven years from now is not feasible.

Nevertheless, ASEAN is not starting from scratch. Building blocks such as the ASEAN Free Trade Area, the ASEAN Investment Area and the ASEAN Framework Agreement on Services are in place to support the AEC initiative, even if they face a number of challenges that need to be seriously addressed.

ASEAN Free Trade Area (AFTA) AFTA is perhaps the most important building block of the AEC. The free trade agreement was launched in 1992 with the signing of the Common Effective Preferential Tariff (CEPT) scheme, which requires member countries to commit to tariff rate reductions on a wide range of products traded within the region to between 0 and 5 per cent. The ASEAN-5 plus Brunei (ASEAN-6) already complied with the CEPT scheme by 2003. Vietnam achieved its tariff elimination target in 2006, Laos and Myanmar will do so by 2008, and Cambodia by 2010. To date, tariffs on almost all ASEAN-6 products under the CEPT have been reduced to between 0 and 5 per cent.

However, cutting tariffs is easier than eliminating non-tariff barriers (NTBs). These barriers to trade include not just border restrictions, but also 'behind the border' measures such as domestic regulations and laws that impede the movement of goods and services across the region. The prevalence of NTBs is reflected in the low level of intra-

ASEAN trade (about a quarter of total ASEAN trade) which has not increased significantly since AFTA was signed in 1992.

Studies in the recently published book, *Brick by Brick: The Building of an ASEAN Economic Community*, find that NTBs are a major impediment to the free flow of goods and services across the ASEAN region. Indeed, the studies found a wide variety of persistent NTBs affecting the integration of most priority sectors. This raises questions on how trade integration can move forward if NTBs are not effectively tackled.

ASEAN Investment Area (AIA) The AIA aims to make ASEAN a highly competitive investment area attracting FDI flows from ASEAN and non-ASEAN investors. It binds member countries to reduce or eliminate investment barriers, and to grant national treatment to ASEAN investors by 2010 and to all investors by 2020. The AIA will encourage investors, particularly from ASEAN countries, to adopt a regional investment strategy and promote industrial efficiency and cost competitiveness. However, given that FDI flows in the region are predominantly driven by non-ASEAN investors (such as the United States, Japanese and European MNCs), the AIA strategy may need a rethink. If the region is no longer competitive, shouldn't the AIA be open to all investors now, rather than by 2020?

ASEAN Framework Agreements on Services (AFAS) AFAS aims to enhance co-operation in the services sector among ASEAN countries by eliminating intra-regional trade restrictions and facilitate free flow of services by 2015. However, progress made in services trade liberalisation has so far been rather slow and uneven. To expedite the negotiation process, the 'ASEAN minus X' principle is currently being applied. This principle allows member countries that are ready to liberalise to go ahead first with other members joining at a later stage

AEC by 2015 So what exactly will be realised by 2015? A European-style single market is not achievable by this time, nor is it politically desirable. Although the ASEAN Charter will provide ASEAN with a legal identity, the regional grouping's institutional structure is likely to remain weak so long as its policy-makers are not more flexible on adopting the concept of 'pooled sovereignty' especially over economic matters. Regional cooperation based on the 'ASEAN Way' decision-making process (based on consensus) not only undermines institutional development but slows down the economic integration process.

Yet, ASEAN could still realise its vision of a highly competitive economic region by 2015. It is possible for ASEAN to have a fully functioning regional free trade area if NTBs

are successfully eliminated. Even this more limited objective would be a realistic AEC end-goal given the short timeline. Also, ASEAN could potentially be a free trade hub as its 'ASEAN+1' FTA with China, Japan, Korea, India, Australia and New Zealand should be fully operational by this time.

The implementation of the AEC blueprint which sets out the approach, targets and milestones leading up to 2015 is absolutely critical. This includes getting member countries to meet the blueprint's demanding targets and deadlines over the next 7 years. The challenge lies in getting member countries to comply with their economic commitments. This is why the ASEAN Dispute Settlement Mechanism (hitherto never used) has to be made workable.

Most importantly, ASEAN policy-makers have to be more decisive in taking the difficult decisions to transform ASEAN's economic vision into a reality.

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Events

29-30 January, *Institutional Foundations for Microeconomic Reform*, workshop, Sydney

25 February, *Roadmap for East Asian Integration*, Economic Research Institute for ASEAN and East Asia workshop, Sydney

Crawford Seminars*

26 February, Philippa Dee, Crawford School, *International Student Movements and the Effects of Barriers to Trade in Higher Education Services*, ANU

Publications

Asia Pacific Economic Papers

369, *China and East Asian energy: prospects and issues*, Vol II, Parts I and II (forthcoming)

New Books

Capturing Wealth from Tuna: case studies from the Pacific, Kate Barclay with Ian Cartwright.

RRP A\$36 ISBN 978-0-7315-3816-4

Asia Pacific Press

Brick By Brick: the building of an ASEAN economic community, Denis Hew (ed.). RRP A\$36 ISBN 978-0-7315-3814-0

Asia Pacific Press and ISEAS Publishing (Singapore)

Japan's Future in East Asia and the Pacific, Mari Pangestu and Ligang Song (eds). RRP A\$40 ISBN 978-0-7315-3815-7

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