

THE AEC – PROGRESS, CHALLENGES AND PROSPECTS

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Drivers of and Impediments to ASEAN Economic Integration

- ❖ ASEAN's economic integration has both market-led and FTA-led, with production networks preceding FTAs
- ❖ Drivers and impediments of FTA-led economic integration:
 - Initial economic diversity an impediment---in economic size (land, population, GDP), level of development (per capita GDP, economic structure), economic openness (trade and FDI regimes) ---leading to reluctance to liberalise trade and investment to perceived “unequal” regional competition
 - Initial low economic interactions ---colonial legacies of N-S trade; similar production and export structures due to similar natural resource endowment and level of technological competence; dependence on FDI from OECD countries.
 - Export manufacturing requires economies of scale from a regional market to achieve global competitiveness
 - External pressures toward economic integration --- completion of Uruguay Round in 1991, formation of NAFTA and EU Single Market in 1992, rise of China and India in 1990s.

Market Integration through Production Networks...1

- ❖ Production network = fragmented production carried out in different cross-border locations, and eventually coordinated for assembly into final products and exported. Production networks usually in industries with long value chains, such as electrical/electronics and automotives.
- ❖ From late 1980s growing intra-regional trade and investment flows with rise of production networks in East Asia, including ASEAN.
- ❖ Factors in rapid growth of production networks in East Asia:
 - Regional differences in wage and labour productivity resulting in different competitive cost locations for different parts of the value chain
 - ASEAN countries switched from import substitution to export manufacturing and attracting FDI through trade and investment liberalisation
 - Cross-border trade flows facilitated by improvements in trade infrastructure – customs, transportation, logistics that lower trade and logistics cost.

Market Integration through Production Networks...2

- ❖ China, Japan and South Korea are home countries of production networks, with China as major assembly hub. Malaysia, Philippines, Singapore and Thailand are major producers of electronic parts and components, while Thailand also assembly hub for automotives. CLV countries are new to production networks.
- ❖ Growth in production network trade in parts and components and final assembled products –by 2006/7 accounted for 66.1% of ASEAN exports and 64% of ASEAN imports.
- ❖ Over 70% of intra-East Asian trade comprises parts and components which are then assembled into final goods and exported to ROW. Over 60% of East Asian exports eventually destined for ROW, mainly US and EU.
- ❖ FTAs can facilitate production networks in ASEAN by attracting MNC investments and facilitating intra-regional trade flows.

AEC: Rationale and Scope

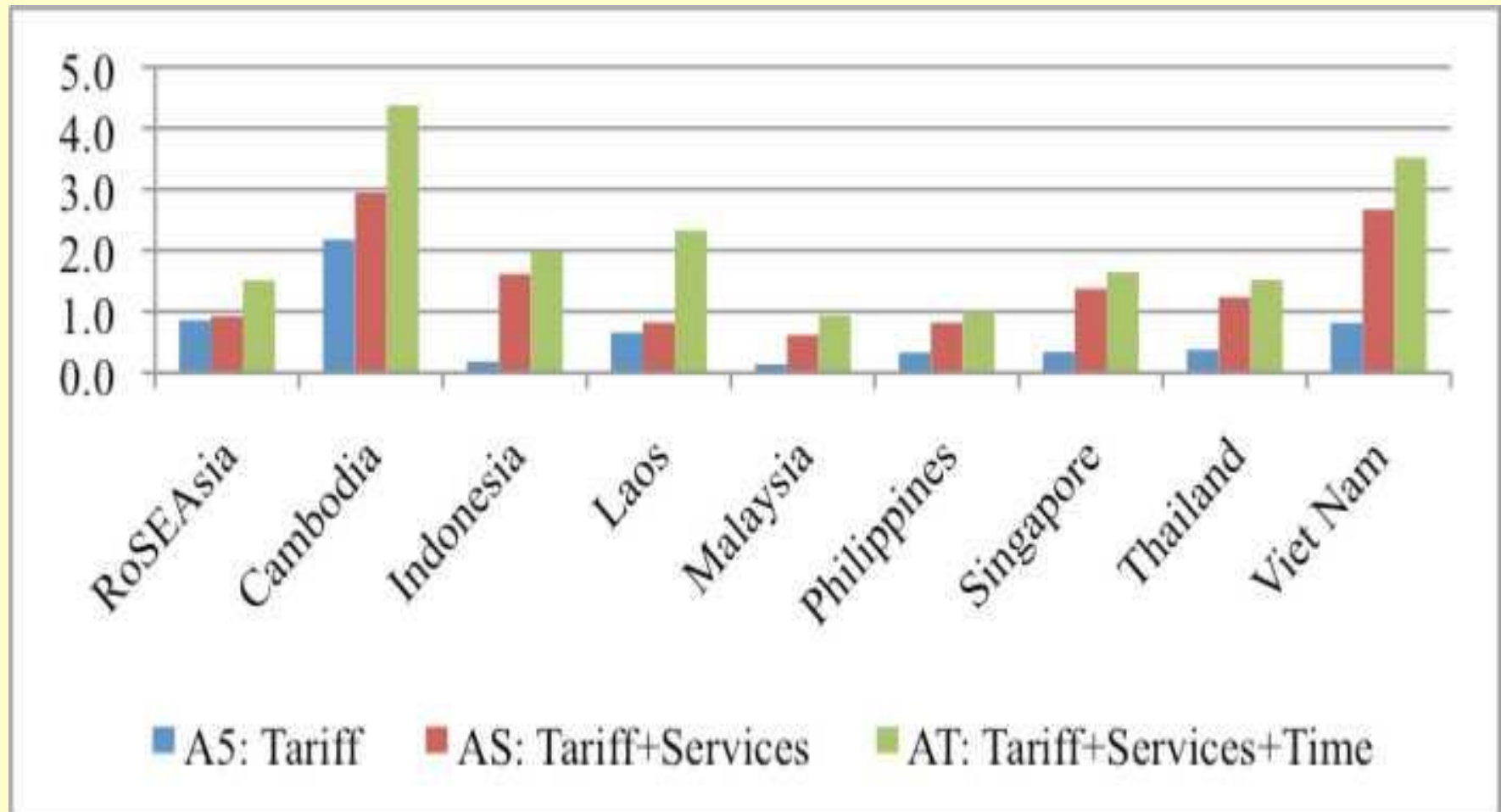
- ❖ In the 1990s ASEAN established AFTA, AFAS and AIA to promote liberalisation and facilitation of trade in goods and services and in FDI.
- ❖ In October 2003, ASEAN agreed to deeper integration through the AEC. Why the AEC? Concern over the loss of competitiveness as a production base and attractiveness to FDI vis-à-vis China (also India). Deeper integration would improve ASEAN global competitiveness. Also concern that ASEAN should be an equitable economic region and not be inward looking. Hence the 4 pillars of AEC are --- single market and production base, competitive economic region, equitable economic development and integration into the global economy
- ❖ AEC target date advanced from 2020 to 2015 for ASEAN6 and 2018-2020 for CLMV. AEC Blueprint adopted in 2007
- ❖ AEC not modelled on the EU. It is neither a customs union (with common external commercial policy) nor a full common market (with free movement of goods, services, capital and labour and some policy harmonisation)

Welfare Gains of AEC in 2015

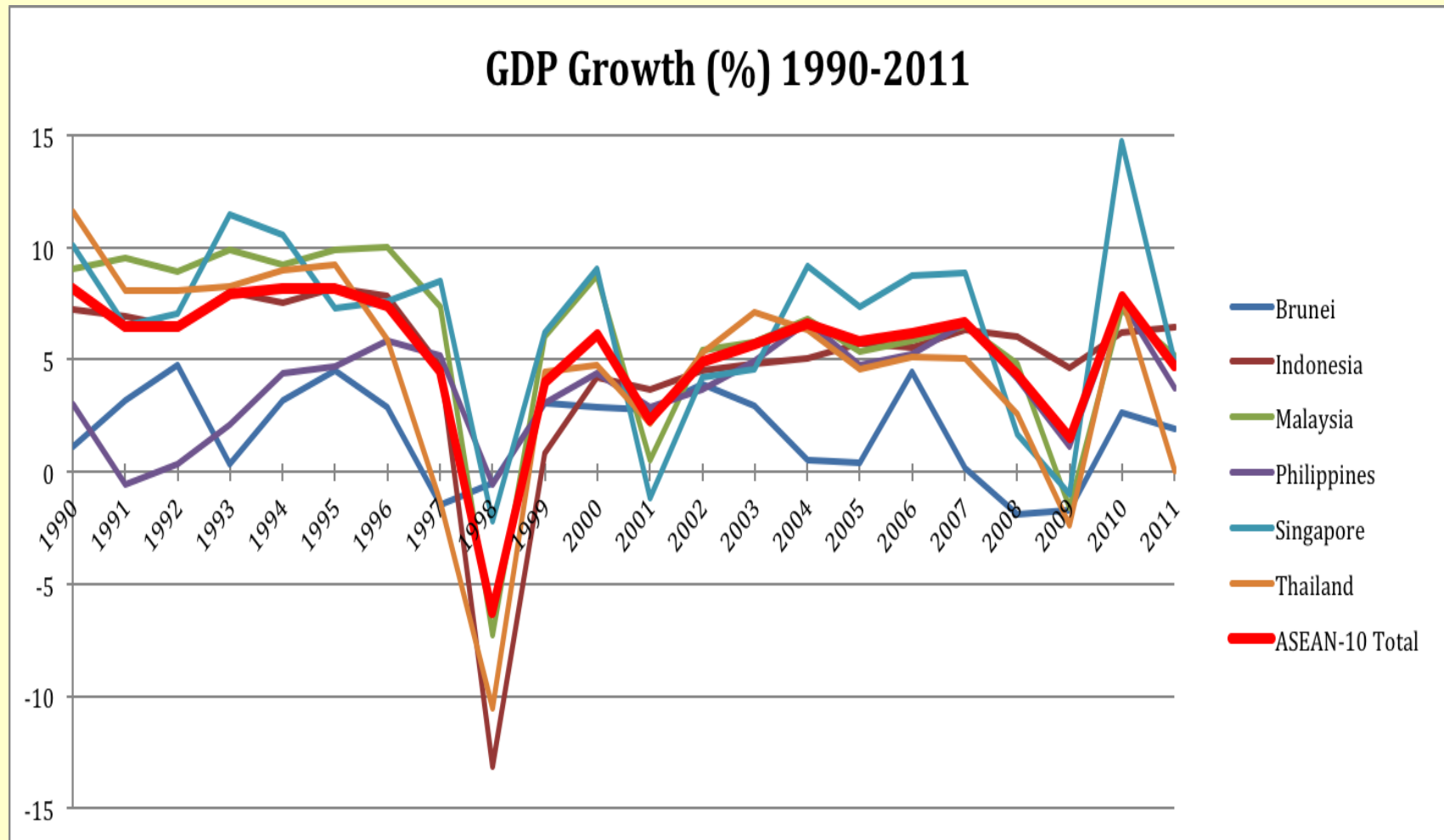
(Plummer-Chia 2009)

ASEAN country ^{2.8}	AEC (US\$ ^{2.8} billion, 2004 prices)	AEC (% of baseline GDP)
Brunei	0.5	7.0
Indonesia	27.6	6.2
Malaysia	5.7	3.0
Philippines	4.5	3.2
Singapore	15.1	9.7
Thailand	12.2	4.9
Cambodia	0.6	6.3
Laos	0.2	3.6
Myanmar	0.6	4.4
Vietnam	2.4	2.8
ASEAN ¹⁰	69.4	5.3

Impact of AEC on GDP (cumulative percentage increase over baseline 2011-2015) (ERIA-2012)



ASEAN6 GDP Growth 1990-2011



CLMV GDP Growth 1990-2011

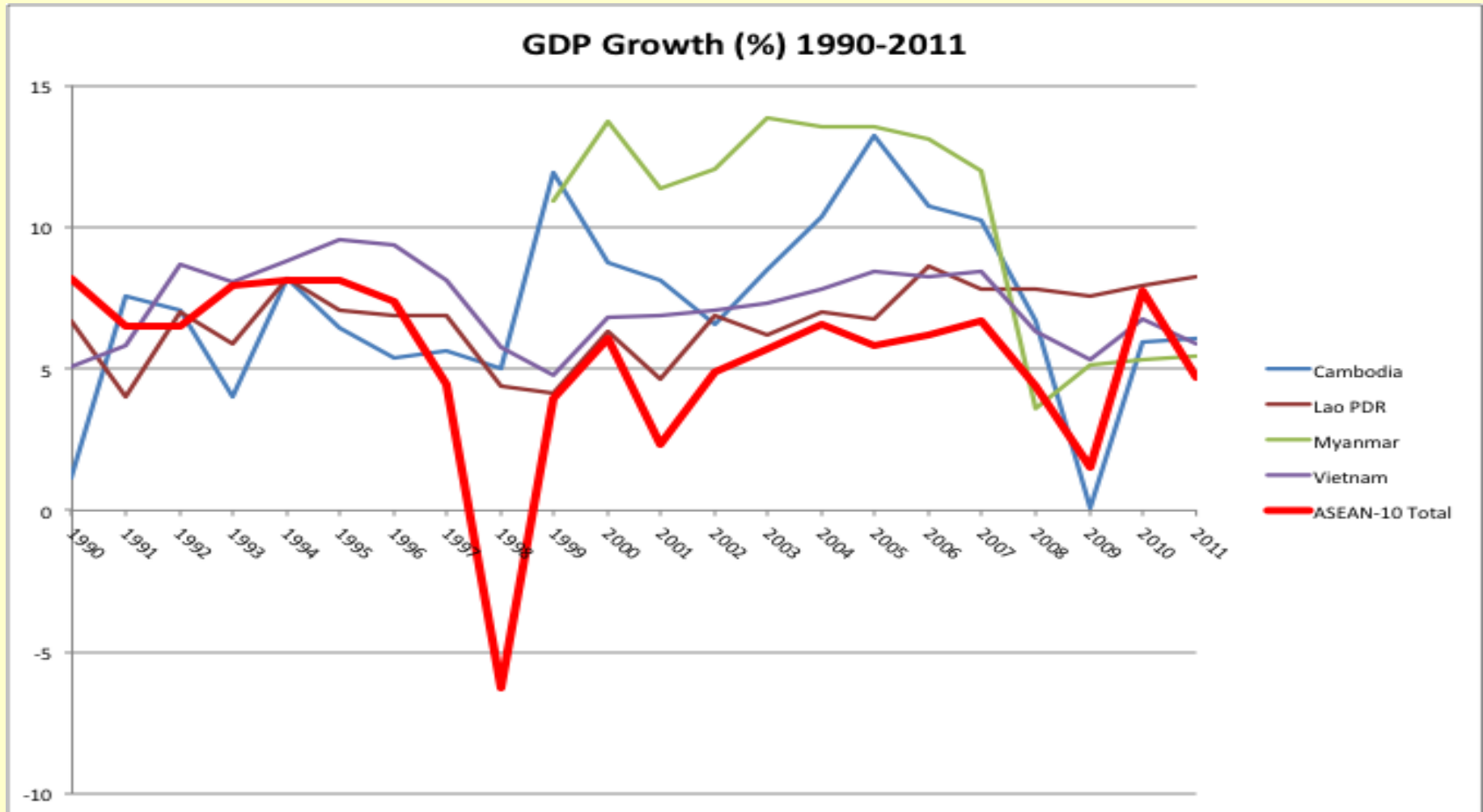
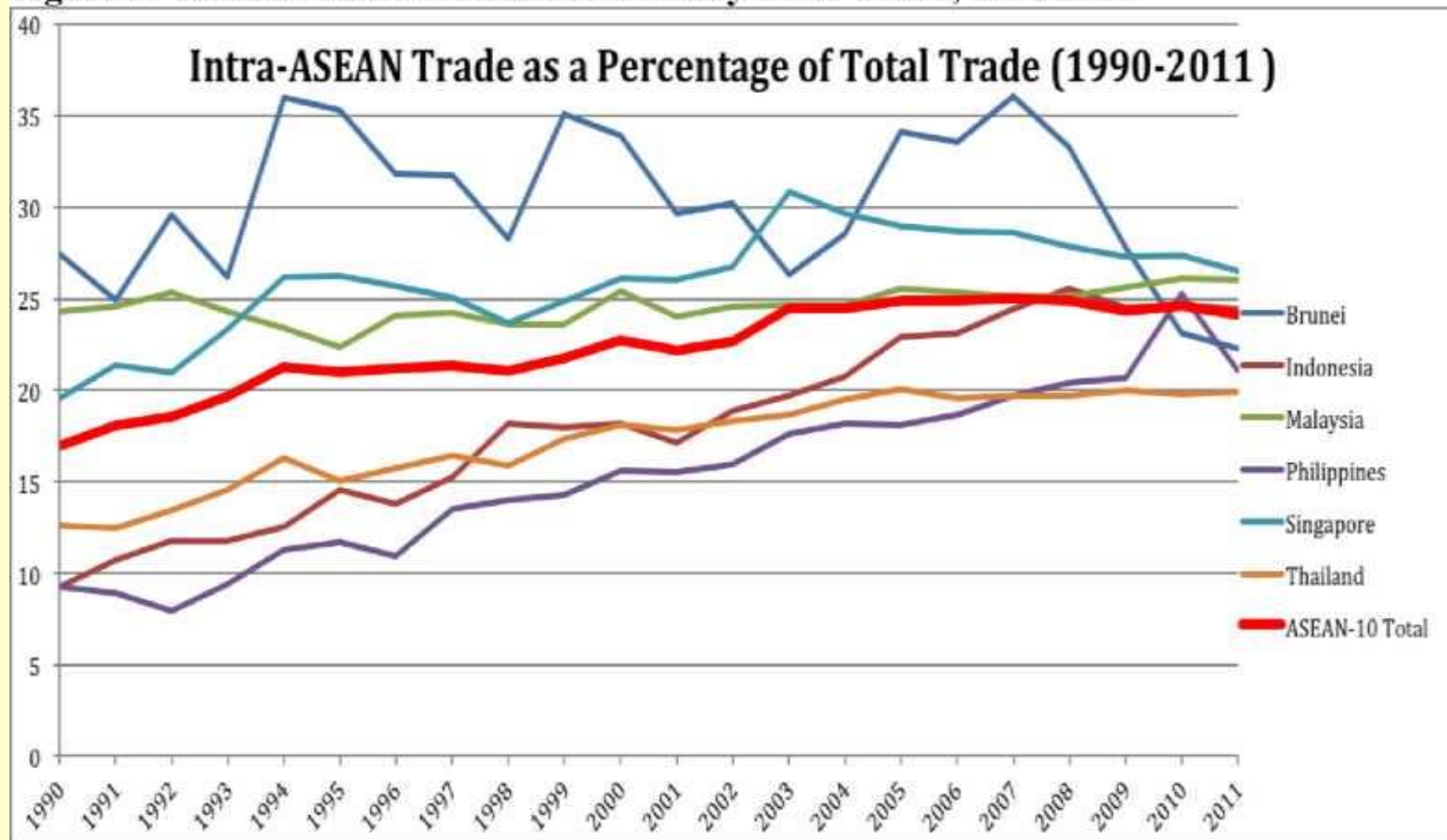


Figure 3: ASEAN Share of Member Country Total Trade, 1990-2011



Intra-ASEAN trade as % of country total trade

Country	1990	2000	2005	2011
Brunei	27.5	33.9	34.1	19.6
Indonesia	9.3	18.2	22.9	26.1
Malaysia	24.3	25.4	25.5	26.0
Philippines	9.3	15.6	18.1	21.1
Singapore	19.5	26.1	31.3	26.5
Thailand	12.6	18.1	20.0	24.3
Cambodia	56.6	24.8	15.8	23.4
Laos	63.2	65.1	65.2	64.0
Myanmar	26.9	35.6	51.2	48.3
Vietnam	16.6	23.5	21.2	17.2
ASEAN10	17.0	22.8	25.5	25.0

Intra-ASEAN Trade Composition 2011 (% distribution)

HS 2-digit level	Exports	Imports	Total
25-27 Mineral products	25.5	30.0	27.5
85 Electrical machinery	18.0	19.6	18.7
84 Machinery	13.0	10.0	11.7
39-40 Plastics & rubbers	7.5	5.6	6.8
72-83 Metals	6.3	6.5	6.4
28-38 Chemical & chem. products	6.0	5.6	5.8
86-89 Transportation	5.5	5.2	5.3
06-15 Vegetable products	4.7	4.5	4.6
16-24 Foodstuffs	4.0	3.2	3.7
Others	9.5	9.8	9.6
Total	100.0	100.0	100.0

Utilisation of FTA Tariff Preferences (Kawai-Wignaraja 2011)

Country	% of surveyed firms using FTAs	% of surveyed firms using and planning to use FTAs
Japan	29.0	47.4
China	45.1	77.9
South Korea	20.8	54.2
Philippines	20.0	40.7
Singapore	17.3	28.0
Thailand	24.9	45.7

FDI Inflows into ASEAN 1993-2011

	1993 US\$million	2011 US\$million	1993-2011 US\$million	1993-2011 % distribution
Brunei	8.0	1208.3	12407.4	1.52
Indonesia	2003.0	18906.0	78792.4	9.63
Malaysia	5741.0	11966.0	99422.8	12.16
Philippines	1238.0	1262.0	28970.0	3.54
Singapore	4686.3	64003.2	407822.0	49.86
Thailand	1807.0	9572.0	109525.7	13.39
Cambodia	54.1	891.7	6029.3	0.81
Laos	29.9	450.0	2493.5	0.30
Myanmar	91.7	850.0	8742.7	1.07
Vietnam	926.3	7430.0	63070.2	7.71
ASEAN10	16585.3	116539.2	817876.1	100.00
% of developing region	21.6	17.0	13.7	

Intra-ASEAN Cumulative FDI Inflows

Host country	1995-2006 (US\$million)	1995-2006 (% distribution)
Brunei	1,434	3.6
Indonesia	4,295	10.7
Malaysia	9,030	22.4
Philippines	1,272	3.8
Singapore	9,459	23.5
Thailand	9,760	24.3
Cambodia	383	0.9
Laos	287	0.7
Myanmar	1,113	2.8
Vietnam	3,286	8.2
ASEAN10	40,316	100.0

Realizing the Objectives of the AEC ...1

- ❖ AEC objectives are: single market and production base, a competitive economic region, equitable economic development, and integration into the global economy. AEC Blueprint actions and measures are inadequate to realise the AEC objectives.
- ❖ Objective of a single market and production base:
 - Are the objectives of single market and production base separate and complementary? What are the specific measures needed to achieve the single market and to achieve the production base? Single market looks primarily at trade barriers (including certification of origin and behind-the-border), whereas production base looks at both trade and FDI barriers (including Mode 3 and Mode 4)
 - Tariff elimination (except for SL and GEL) is complete for ASEAN6 and nearing completion for CLMV. Rules of origin have been modified to make them more business friendly.
 - NTB removal record is unsatisfactory. NTBs are notoriously difficult to identify and remove as not all NTMs are NTBs and some are imposed for health and security reasons. More needs to be done.

AEC Blueprint – 4 pillars and core elements

Pillars	Core elements
A. Single market & production base	A1. Free flow of goods: 9 strategic approaches
	A2. Free flow of services: 3 strategic approaches
	A3. Free flow of investment : 5 strategic approaches
	A4. Freer flow of capital: 7 strategic approaches
	A5. Free flow of skilled labour
	A6. Priority integration sectors
	A7. Food, agriculture and forestry
B. Competitive economic region	B1. Competition policy
	B2. Consumer protection
	B3. Intellectual property rights
	B4. Infrastructure development: 10 strategic approaches
	B5. Taxation
	B6. E-commerce
C. Equitable economic development	C1. SME development
	C2. Initiative for ASEAN Integration
D. Integration into global economy	D1. Coherent approach toward external economic relations
	D2. Enhanced participation in global supply networks

Realizing the Objectives of the AEC ...2

- As tariffs decline, trade facilitation measures become more important --- customs procedures are improving, but uncertainties of outcome due to differences in interpretation and corruption, implementation of ASEAN single window has fallen behind schedule, infrastructure implementation has long gestation period and needs financial resources. ASEAN Infrastructure Fund and Master Plan on ASEAN Connectivity will improve matters.
- Utilisation rates of FTA tariff preferences could be much improved ---requires better outreach to SMEs, simplification and certainty of procedures to reduce transaction costs.
- With the achievement of goods liberalisation, services liberalisation under AFAS has become more important but progress is slow. A positive list approach and flexibilities and carve-outs have led to the slow liberalisation of sectors and Mode 3 and Mode 4.
- ASEAN is heavily dependent on inward FDI, hence there is need to further improve investment climate and implementation of AIA and ACIA. Countries need to examine their exclusion lists and raise foreign equity cap of 70%.

Realizing the objectives of the AEC ...3

Countries should also avoid flip-flops in investment policies that create uncertainties for investors. Improve the indicators in the “ease of doing business” index and improve the AEC dispute settlement mechanism.

- On mobility of skilled labour, developing MRAs for professionals is not enough to assure market access. Need to eliminate domestic regulations and private sector practices that limit the employment of foreigners.

❖ Objective of a competitive economic region:

- Need to improve the competitive environment and ensure a level playing field for domestic and foreign players and between domestic SOEs and SMEs
- Need to implement domestic competition policies and enforce IPRs.
- Since ASEAN countries have entered into FTAs with government procurement, labour and environmental provisions, they should also be included in the AEC

❖ Objective of equitable economic development:

- To narrow development gap, particularly between ASEAN6 and CLMV, SME development and IAI are not enough ---promote more intra-ASEAN investments from richer ASEAN states; promote CLMV integration into production networks and global supply chains; accelerate connectivity through

Realising the Objectives of the AEC...4

- transportation, communications and logistics development.
 - More technical/financial assistance to accelerate human resource development and institutional capacity for CLMV. Promote learning from the development experiences of the more developed countries and adoption of best practices by the CLMV.
 - A structural fund or social cohesion fund a la the EU is more problematic for the AEC --- the richest countries are small (Brunei, Singapore) and the largest countries have low per capita incomes (Indonesia, Philippines, Vietnam, Myanmar: there is no common source of revenue for distribution.
- ❖ Objective of full integration into the global economy: This signals that ASEAN is practising open regionalism with minimal trade diversion effects on rest of the world. ASEAN has been implementing or negotiating FTAs with its major trade and investment partners. Need to accelerate the RCEP. Need to continue to embrace multilateralism in the WTO.

AEC Blueprint – Scorecard Results...1

- ❖ ASEAN Secretariat's published Scorecard tracks implementation of the 4 AEC pillars and various measures in the AEC Blueprint.
- ❖ The overall implementation rate for 2008-2011 is only 67.5% and is a cause for concern given the imminent deadline of 2015. The implementation rates are higher for Phase I than for Phase II ---does this reflect increasing difficulties in later phases, as the low hanging fruits are plucked first?
- ❖ Scores are highest for integration into the global economy but less than 70% for other pillars.
- ❖ The Scorecard publication in its current form is not useful for businesses or analysts:
 - Problematic definition of “implementation”. Implementation simply refers to national ratification of AEC agreements and measures . A further step needed is translating regional initiatives into domestic laws, strengthening internal coordination mechanisms, and putting the agreements and measures into action.
 - It tells nothing about compliance record of individual countries on the specific measures. There are no penalties for non-compliance. Even the pressure of

AEC Blueprint – Scorecard Results...2

“name and shame” is absent since countries’ compliance records are kept secret.

- Scorecard only relates to compliance on the specific actions in the AEC Blueprint. It gives no indication of how far the objectives of the AEC are being realised.

❖ Implementation problems in AFTA, AFAS and AIA (Hanoi mid-term review 2001 and Severino 2006)

- Inadequate vision of common destiny among governments and little pressure from national private sectors due to traditional extra-ASEAN orientation of economies and businesses
- Weak commitments to some of the decisions to promote liberalisation and cooperation programmes --- due to poor awareness of benefits, late submission of full information, low level of representation at meetings and negotiations leading to inability to make timely decisions.
- Need to consider and consult diverse national interests, particularly when there are perceived conflicts with various group interests.

AEC Blueprint- Scorecard Results ...3

- Necessary national legislations and regulatory reforms are time-consuming
 - Some countries lack institutional capacity and human resource for implementation
 - Removing tariffs is relatively easy compared to removing NTBs, reforming and streamlining Customs, and improving transportation and logistics.
- ❖ AEC Blueprint implementation (AEC Scorecard 2011 and ERIA mid-term review 2012)
- Problematic areas are measures pertaining to services liberalisation, trade facilitation, and free flow of skilled labour
 - ERIA MTR notes that the AEC is already contributing to surge in FDI into ASEAN, but there remains need to reduce the ACIA Reservations List. Tariff elimination has led to rise in ASEAN countries import sourcing from other members.

Implementation of AEC Scorecard 2008-2011 (per cent of targets achieved)

	Phase I 2008-09	Phase Ii 2010-11	Phases I&II
Single market & production base	93.8	49.1	65.9
Competitive economic region	68.7	67.4	67.9
Equitable economic development	100.0	55.5	66.7
Integration into global economy	100.0	77.8	85.7

Issues of AEC 2015 and Beyond

- ❖ Monitoring the progress of the AEC should be strengthened. This calls for strengthening the resources and monitoring and coordinating role of the ASEAN Secretariat.
- ❖ Deepening into a customs union and common market?
 - An FTA or customs union has been debated since implementation of AFTA. There is no easy solution given the differences in MFN tariff and NTB levels among ASEAN countries.
 - On the issue of labour mobility, implementing the skilled labour commitments poses a challenge, but allowing free movement of unskilled labour is even more challenging, given the huge diversities in labour force size, unemployment rates and wage levels among ASEAN countries. The present immigration problems in the EU calls for a cautious approach in ASEAN.
 - While there is significant monetary and financial cooperation among ASEAN and ASEAN+3, monetary and financial integration in ASEAN is still a long way off. The problems in the EU are cautionary lessons for the AEC.

END OF PRESENTATION

THANK YOU