The ASEAN Economic Community: What Stands in the Way?

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SUMMARY  At the end of 2015 the Association of Southeast Asian Nations (ASEAN) will announce the establishment of the ASEAN Economic Community (AEC). In theory, this agreement should produce an association-wide economic integration. However, following the announcement, and for the foreseeable future, ASEAN member states will continue in significantly less than full regional economic integration. Why? Some observers believe that the AEC plans involve an “overly ambitious timeline and too many ill-thought-out initiatives.” Others point to ASEAN’s traditional aversion to legally binding agreements. While progress has been made in reducing or eliminating intra-ASEAN trade tariffs, substantial non-tariff barriers to trade persist. However, for most member states, the ASEAN market is relatively small while external markets, especially China, are growing rapidly. Given this outward-orientation for ASEAN trade, is the lack of an unhindered regional market really a problem?
Analysis from the East-West Center

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We do not need a crystal ball to predict two developments in the near future. First, on December 31, 2015, Malaysia’s current chair of ASEAN (the Association of Southeast Asian Nations), will—with great fanfare—announce the establishment of the ASEAN Economic Community (AEC). Second, this community will be anything but the envisioned single market and production base in the common international understanding of the term.

ASEAN scores high on the political, legal, institutional, and technical frameworks that govern regional economic integration. A multitude of agreements in facilitation of the free flow of goods and services, intraregional investments, customs harmonization, standards, and non-tariff barriers to trade, to name the most relevant ones, could be expected to lead to an economic community. Actual implementation, however, lags significantly behind the timelines of stated objectives. Both political and economic concerns are to blame for the slow process toward a real ASEAN economic community.

Economic community building in Southeast Asia has been in the making for almost five decades. The foreign ministers of Indonesia, Malaysia, the Philippines, Singapore, and Thailand took the first tentative and cautious steps when they gave birth to ASEAN in 1967. The organization was later joined by Brunei, Cambodia, Laos, Myanmar, and Vietnam. However, the general and vague provisions of the Bangkok Declaration, ASEAN’s founding document, did not include any firm commitment to regional economic integration. The declaration simply stressed the desirability of collaboration and mutual assistance on matters of common interest in the economic field, among other areas of potential cooperation. It was only a decade later, in 1977, that the ASEAN member states signed a Preferential Trading Arrangement (PTA) as a first serious effort to strengthen regional economic relations.

By the early 1990s, tariffs on some sixteen thousand goods within the PTA framework had been reduced. While this figure looked impressive on paper, it amounted to only about 5 percent of total intrASEAN trade. Excluded were the main export and import products, which remained protected by high tariff barriers. The member states also demonstrated some creativity in listing products under the PTA with little or no relevance for intraregional trade—snow plows and nuclear reactors are oft-noted examples.

An Important Milestone

The PTA nevertheless signified an important milestone as it marked the end of some member states’—especially Indonesia’s—categorical resistance to trade liberalization. After several subsequent and mostly failed strategies in support of economic integration, a major breakthrough was achieved when, in 1992, the member states agreed on the gradual implementation of an ASEAN Free Trade Area (AFTA). The Asian financial crisis of 1997–1998 interrupted this process. However, the ASEAN heads of states and governments provided fresh impetus at their summit meeting in Bali in 2003. The Declaration of ASEAN Concord II envisioned building an ASEAN economic community to “establish ASEAN as a single market and production base” by the year 2020. In 2007, the ASEAN Economic Community (AEC) Blueprint set out the framework and roadmap for implementation and shortened the deadline to 2015.

The AEC is based on four “pillars”:

- single market and production base;
- competitive economic region;
- equitable economic development; and
- integration into the global economy, committing ASEAN to work toward maintaining “ASEAN Centrality” in its external economic relations, including, but not limited to, its negotiations for free trade agreements (FTAs) and comprehensive economic partnerships (CEPs).

Each pillar is defined by detailed implementation objectives, timelines, and action points. For example, the single market and production base comprises five core elements: free flow of goods, free flow of services, free flow of investment, freer flow of capital, and free flow of skilled labor. Progress toward achieving the agreed goals is monitored through the “ASEAN Scorecard” mechanism established in 2008.
However, the Jakarta-based ASEAN Secretariat is neither mandated nor positioned to assess the progress of AEC implementation independently. Instead, it prepares the scorecard based on data provided by the ASEAN member states. Consequently, the current approach to monitoring and disseminating data on regional economic integration is largely driven by political motives and incentives—for example the need for national governments, and ASEAN collectively, to demonstrate substantial progress toward the implementation of the AEC.

As early as 2012 the ASEAN Scorecard reported that 65.9 percent of all agreed measures to achieve the single market and production base had been fully implemented. In late 2014 an independent assessment by the Asian Development Bank Institute painted a more sober picture and concluded that the December 2015 deadline for realizing all four pillars of the AEC will be missed due to an “overly ambitious timeline and too many ill-thought-out initiatives.”

Shallow Integration

The AEC reflects the same hesitant pattern of regional collaboration that was evident under the PTA and other economic cooperation ventures, including the AFTA. To many observers, ASEAN is a prime example of “shallow integration” that is based mainly on political motives and not economic factors. Such arrangements are characterized by the “use of economic instruments to pursue political objectives.” Helen Nesadurai of Monash University points to the Southeast Asian preference for “mixed trade regimes that accommodate both trade liberalization and protection” due to the “central role of economics played in politics and the close government-business relations embedded within patronage networks that shape a good many economic policy choices, including trade policy.”

The process of implementing the AEC gives evidence of this assessment. On the positive side, and most decisively perhaps, tariffs in intraregional trade have been substantially reduced. Yet this achievement is put into perspective by creeping protectionism based on non-tariff measures. The number of such measures has been steadily increasing in the largest ASEAN economies. From 2009 to 2013, a total of 186 non-tariff measures were put in place. The majority of these were quantity-control measures (quotas) and technical regulations.

At the same time, progress in realizing the goals of liberalizing investment and capital flows has been slow. With the exception of Singapore, services trade is also limited due to restrictions in most member economies. According to World Bank data, several ASEAN states (Cambodia, Malaysia, and the Philippines) have “virtually closed” or “completely closed” (Thailand) their borders to professional services (accounting, auditing, and legal services) from other member states.

In short, the main hurdle in the process of implementing the AEC is the mismatch between political ambitions and the capabilities and, often, political will—or, maybe better: political autonomy—of several member states to walk the talk. One of the striking characteristics of the regional integration process in Southeast Asia is the gap between ambitious political goals (the visions for economic integration as prominently spelled out in the AEC Blueprint and also the ASEAN Charter) and the realities of substantial development gaps, nationalism, and the prevalence of vested interests, or what Lee Jones calls the “socio-political contestation over the distribution of economic power and resources.” The argument is fought between the sizable number of pro-liberalization technocrats and international proponents of deeper integration, on the one hand, and, on the other, a broad range of political, bureaucratic, and economic actors who, for varied reasons, prefer the status quo. Such a setting is not uncommon for processes of regional integration. In ASEAN it is intensified by considerable disparities in technical and institutional capacities, economic development, and political priorities. Thus, the basic conditions for creating common regimes or even for harmonizing national legislative frameworks and enforcement practices among the members are not yet in place.

Should a faster pace of implementation really be expected against the backdrop of the high degree of diversity in Southeast Asia? This area includes some of the richest, but also some of the poorest, nations...
in the world. Democracies co-exist here with authoritarian regimes. Singapore’s gross domestic product (GDP) per capita is 56 times larger than Myanmar’s (Figure 1). By comparison, the ratio between the largest and smallest national GDP per capita in the European Union (EU) is only roughly 15:1 (between Luxembourg and Bulgaria).

To date, even the lowest level of economic integration—regional free trade—is not fully achieved in Southeast Asia, not even among the “old” ASEAN-6 (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand). The oft-cited figure according to which 99 percent of trade among ASEAN-6 has been liberalized is misleading. In reality the figure does not use the total regional trade volume as the baseline, but indicates the share of the total number of goods which are included in the ASEAN Trade in Goods Agreement (ATIGA), a main element of the AEC, and for which import duties have been eliminated. Most ASEAN member states have made use of an extensive and ever-expanding exclusion system and placed products on the Temporary Exclusion List, the Sensitive and Highly Sensitive List, or the General Exclusion List. For example, rice—one of the most important commodities in regional trade—is excluded from ATIGA.

A further issue is the under-utilization of ATIGA; less than 10 percent of intra-ASEAN trade makes use of AFTA concessions. The relative insignificance of the ATIGA regime is partly related to the Rules of Origin (RoO) documentation required. RoO are a central element of any free-trade agreement as duties and restrictions are usually determined based on the country of origin. Hence, RoO are used to define where a product was made. The cost of proving origin (e.g., for computation of costs, invoicing, and/or other documentation) can be high, especially for small and medium enterprises (SMEs) from less-developed economies.

**Difficult to Comply With**

ASEAN’s value added (VA) rule is simple in principle—it requires that products qualifying for preferential tariff treatment under ATIGA must have 40 percent “regional value content”—but difficult to comply with. Exporters from ASEAN member states are often not in a position to accumulate the necessary local or regional content. This is partly due to a high degree of production fragmentation. Roughly half of ASEAN trade is in electronics and machinery, where production networks are widespread. Consequently the product content from non-ASEAN sources is often high, making it difficult to meet the 40 percent VA rule.

The documentation process for exporters to prove RoO and to benefit from preferential tariff treatment is called “Form D.” Surveys show that many businesses are unaware of the existence of this process. As well, ASEAN’s industries are dominated by SMEs, which account for between 95–98 percent (according to different estimates) of all association enterprises. Most of these have little interest and opportunity to expand across national borders.

All this helps explain why intra-ASEAN trade as a percentage of ASEAN’s total trade has grown only marginally since the late 1990s and has been virtually stagnant for the past decade (Figure 2). Also note that three member states account for 71 percent of the intra-ASEAN trade volume. Singapore’s exports and imports within ASEAN represent about 34 percent, Malaysia’s 20 percent, and Thailand’s 17 percent.

The relatively small size of the ASEAN market and the outward-orientation of the member states are other
important factors standing in the way of deep economic integration. Overall, the national economies are more competitive than complementary in structure. They produce a narrow range of similar primary products and labor-intensive manufactured goods for export. The intra-industry specialization and regional division of labor, though improving, are not yet well developed.

Intra-ASEAN trade has grown at a much slower pace than ASEAN’s total trade. Since 2000 the general trend has been, first, a decrease of ASEAN’s trade volume with the United States and the EU and, second, a substantial increase of ASEAN’s trade with other Asian economies (except Japan). This is particularly the case for China, which is now ASEAN’s largest trading partner (Figure 3).

Growing Extra-regional Orientation

This growing extra-regional orientation is reflected by the fact that most member states individually, and ASEAN collectively, have been increasingly active in negotiating bilateral and multilateral FTAs with third countries and organizations. As of April 2015 Singapore had a total of 22 extra-regional trade agreements (bilateral and multilateral treaties in goods and/or services) in place, followed by Malaysia (12), Thailand (10), Vietnam (9), Philippines (8), Laos (8), Indonesia (7), Brunei (7), Myanmar (6), and Cambodia (5). Hence, with regard to “Integration into the Global Economy,” one of the four pillars on which the AEC is based, ASEAN has made visible progress.

Razeen Sally of the Lee Kuan Yew School of Public Policy rightly points out that “incremental progress, not a utopian leap to EU-style top-down, institution-heavy integration, is probably the best ASEAN can expect given its political realities.” This gradual approach is not without successes, even in the context of creating a regional single market and production base. Indeed, implementation has not been as fast as had been hoped and expected, but progress in some sectors is indisputable.

The AEC Blueprint stipulates that simple, harmonized, and standardized trade and customs processes, procedures, and related information flows are expected to reduce transactional costs in ASEAN. In particular, the ASEAN Customs Vision 2020 (brought forward to 2015) and the related Strategic Plan of Customs Development aim to, among other things, integrate customs structures; modernize tariff classification, customs valuation, and origin determinations and establish ASEAN e-customs; smooth customs clearances; and strengthen human-resources development in the customs sector.

Data from the Global Trade Enabling Report (“The Enabling Trade Index”), which has been published by the World Economic Forum since 2008, shows that in the five years between 2009 and 2014 customs procedures became more efficient and transparent. As a result the cost of importing and exporting has indeed been reduced. The index uses several indicators to measure the efficiency of customs administration, the efficiency of import-export procedures, and the transparency of border administration. The data show notable improvements across ASEAN. For example, the Philippines has seen an efficiency...
increase of 0.6 from a value of 3.7 (2009) to 4.3 (2014). The higher the score (on a scale from 0 to 7), the more efficient and transparent is the respective border administration.

Staying with the example of the Philippines, a closer look at the individual indicators on which the report’s assessment is based reveals that the country has improved its customs-related procedures in all categories. According to the data of the 2009 and 2014 reports,

- the efficiency of the customs clearance process increased from 2.6 to 3.0 (on a scale from 0 to 5);
- the number of days it takes to complete the import procedure was reduced from 16 to 14, while the number of days for export was cut slightly from 16 to 15;
- the number of documents needed was reduced from eight to seven for imports and from four to three for exports; and
- the cost to import a container decreased significantly from US$819 to US$660, while the cost to export a container fell even more markedly, from US$816 to US$585.

No aspect of economic integration has attracted more donor attention than customs harmonization. It is in the natural interest of Organisation for Economic Co-operation and Development/OECD donors to ease the access of exporters to the Southeast Asian markets and thereby strengthen trade relations.

In customs harmonization and in other fields of the AEC, for instance in the area of technical standards, the European Union has played a particularly important role. Based on its own history and legacy, the EU has generally been a long-standing supporter of regional integration in developing countries. Support to regional organizations lies at the core of the EU’s trade-related assistance to other countries and regions. Between 2007 and 2013 the EU allocated €79 million of official development assistance to the support of regional integration in Asia. Of this amount 46 percent, or €31.7 million, was assigned to ASEAN.

Although this may not appear to be an enormous amount, the support is significant. ASEAN’s official annual budget of US$16.2 million (2013)—the sum of 10 equal contributions of the member states—covers little more than the operational budget of the ASEAN Secretariat. ASEAN’s own funds are insufficient to provide the financial means for the realization of the AEC. A recent independent evaluation of the EU’s cooperation with Asia found that

“The EU is seen as ASEAN’s most trusted and relevant partner, given the importance of the European integration process as a reference point (but not necessarily a model) for ASEAN’s own regional integration […] The EU has made a significant and effective contribution to the strengthening of the legal and institutional settings that form the pillars of economic integration in ASEAN. The EU […] support has addressed the crucial and central agendas in this process—such as standards, SPS, IPR, statistics—and thereby has helped ASEAN move closer to achieving the vision of the ASEAN Economic Community 2015.”

Achievements Are Linked to Externally-Funded Support

In the Philippines and elsewhere in the region, the achievements in the customs sector are prominently linked to externally funded support. Since 2005, up to two thousand technical-assistance and capacity-building projects in about 50 different sectors have been conducted to achieve the customs-related goals as set out in the AEC Blueprint and related agreements. Virtually all of these interventions have been funded through multimillion-dollar donor programs, including the ASEAN Programme for Regional Integration Support (APRIS) and the follow-up ASEAN Regional Integration Support from the EU (ARISE; both European Union), the ASEAN Trade Pilot Program: Single Window (United States Agency for International Development/USAID), the ASEAN-Australia Development Cooperation Program Phase II (Australia), Support for ASEAN Integration (Japanese International Cooperation Agency/JICA), and dozens of projects focusing on individual ASEAN member states.

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be considered as a blueprint for Southeast Asia. There are striking historical, political, economic, and institutional differences between the two regions. Most importantly, the EU is a supra-national organization with the European Commission (EC) as its executive arm. The EC, which comprises a workforce of thirty-three thousand officials, has the power to propose legislation, implement decisions, uphold the body of EU treaties, and manage the day-to-day affairs of the EU.

By contrast, ASEAN is an intergovernmental organization in which the member states retain national sovereignty. Unlike the EC, the ASEAN Secretariat does not possess executive powers. The small office, with just 300 employees, mainly coordinates regional cooperation in economic and other fields within Southeast Asia and in ASEAN’s relations with external partners. It also facilitates and monitors progress in the implementation of ASEAN treaties and decisions.

While it can be concluded that, at least in some sectors, important progress has been made, ASEAN still has a long way to go and the AEC will remain a work in progress long beyond 2015. Regional economic integration is as much a top-down approach as it is a bottom-up phenomenon.

In a mutually reinforcing process, governments create the structural frameworks to facilitate a widening and deepening of cross-border economic interactions while private companies take their own initiatives to create business opportunities beyond national markets for themselves. ASEAN’s problem is that neither dimension is yet fully developed.

Rejecting a Legalistic Approach

It would be wrong, however, for governments to blame the private sector for not taking advantage of existing rules. The emergence of a “regional mind set” among businesses would be an important step. But this “regional mind set” can only translate into a substantial expansion of regional activities if governments establish the appropriate regulative structures. ASEAN has deliberately rejected a legalistic approach to regional integration based on stringent regulatory frameworks.

ASEAN, instead, developed an alternative approach to regional community building widely known as the “ASEAN Way.” It rests on the pillars of informal, non-binding, and consensus-oriented intergovernmental cooperation. There can be no doubt that the ASEAN Way has served the organization well and provides a suitable foundation for effective cooperation in a large number of policy fields.

However, economic integration cannot work on the basis of non-binding agreements. If member states are allowed to opt-out at any time, or to choose not to implement agreed actions, integration is hardly achievable. Yet, this is exactly what happens under the “ASEAN minus-X” formula that guides almost every aspect of liberalization and integration. This formula allows member states to join the bandwagon in their own time. ASEAN members are trying to achieve far-reaching visions of economic community building without the necessary modifications to the traditional ASEAN Way.

ASEAN’s members have committed to establishing the AEC with its precise targets and action plans. Hence the oft-heard argument that legally binding decision making would be an alien concept in the Southeast Asian context is no longer a convincing excuse for the delay in the implementation process.

Is Deep Regional Economic Integration Needed?

The question remains, though, if deep economic integration is truly needed or even desirable for a region as diverse and outwardly oriented as ASEAN. To some extent ASEAN created this dilemma for itself. It has—possibly prematurely—announced its intention to establish a single market. Now it will somehow have to find a way to achieve this goal or ASEAN is likely to lose credibility. It is correct to note that, despite the often frustratingly slow progress toward regional integration, ASEAN is still the most effective and coherent organization among the non-European regional organizations. But the success of the AEC will be measured against ASEAN’s own visions and roadmaps—not the shortcomings and failures of regional-cooperation agreements and organizations in other parts of Asia, Latin America, or Africa.
Notes

13 Total number of Regional Trade Agreements (RTAs) announced to the WTO, excluding the ASEAN Free Trade Area (AFTA), according to the WTO Regional Trade Agreements Database, https://www.wto.org/english/tratop_e/region_e/region_e.htm (accessed March 10, 2015).

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