

Chia, Siow Yue

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## The ASEAN Economic Community: Progress, challenges, and prospects

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## **ADB Working Paper Series**

### **The ASEAN Economic Community: Progress, Challenges, and Prospects**

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Siow Yue Chia

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Siow Yue Chia is Senior Research Fellow at the Singapore Institute of International Affairs.

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Please contact the authors for information about this paper.

Email: [chiasy@singnet.com.sg](mailto:chiasy@singnet.com.sg)

Asian Development Bank Institute  
Kasumigaseki Building 8F  
3-2-5 Kasumigaseki, Chiyoda-ku  
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500  
Fax: +81-3-3593-5571  
URL: [www.adbi.org](http://www.adbi.org)  
E-mail: [info@adbi.org](mailto:info@adbi.org)

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**Abstract**

Serious efforts at economic integration among the Association of Southeast Asian Nations (ASEAN) members started only in 1992. Initial obstacles included the widespread pursuit of import substitution policies of industrialization, the small extent of intra-ASEAN trade, and the wide differences in economic size, development level, and industrial competence giving rise to widely divergent perceptions of benefits and costs of integration. The switch to outward-looking development strategies and external pressures (such as the formation of the European Union Single Market and the North American Free Trade Area) pressured ASEAN to form a free trade area (FTA) in 1992. The challenges of globalization, slow recovery from the Asian financial crisis, and the economic rise of the People's Republic of China (PRC) and India further pressured ASEAN into deep integration in 2003 with the formation of the ASEAN Economic Community (AEC). The AEC has objectives of a single market and production base, a competitive economic region, equitable economic development, and integration into the global economy. It involves liberalization and facilitation of trade in goods, services, and investment, as well as protection and promotion of investment; narrowing the development gap; and free flow of skilled labor and freer flow of capital. The AEC Blueprint outlines actions and measures and time lines for completion by the 2015 deadline. However, by end-2011 only an implementation rate of 67.5% had been achieved. While tariff elimination had largely been on schedule, there were difficulties with removal of non-tariff barriers (NTBs) and services and investment liberalization.

In summary, the AEC has come a long way, but it has fallen short of the high standard and time frame it has set for itself. ASEAN has to find the political will and management capability to fulfill all goals in the AEC Blueprint and embark on further liberalization, rationalization, and integration to seize the opportunities and successfully meet the economic challenges of the 21st century.

**JEL Classification:** F13, F15, O19, O24

## Contents

1.	Introduction.....	4
2.	ASEAN Economic Integration in the 1980s–1990s .....	5
2.1	Factors Pushing or Impeding ASEAN Economic Integration .....	5
2.2	Market-Driven Integration through Production Networks .....	7
2.3	FTA Driven Economic Integration in the 1990s .....	10
3.	The AEC—Rationale, Progress, and Shortfalls.....	10
3.1	Rationale and Process Towards AEC .....	10
3.2	Quantifying the Expected Benefits of the AEC .....	12
3.3	The AEC Blueprint and Progress .....	13
3.4	Measuring Progress in ASEAN Economic Integration .....	24
3.5	AEC Scorecard for 2008–2011.....	28
4.	The AEC by 2015 and Beyond .....	31
4.1	Implementing the AEC Blueprint by 2015.....	31
4.2	Realizing the AEC Objectives.....	32
5.	Conclusion — Moving Beyond 2015 .....	34
	References .....	36

# 1. INTRODUCTION

The Association of Southeast Asian Nations (ASEAN) was formed by Indonesia, Malaysia, Philippines, Singapore, and Thailand in 1967 mainly to foster regional peace and security. Brunei Darussalam joined in 1984, and Cambodia, Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam (CLMV) joined between 1995 and 1999. Economic cooperation and integration began modestly in 1977 with the Preferential Trading Arrangement and a number of industrial cooperation schemes. Economic integration began with the 1992 ASEAN Free Trade Area (AFTA) that covers trade in goods, complemented by the 1995 ASEAN Framework Agreement on Services (AFAS) and the 1998 ASEAN Investment Area (AIA) agreement. In 2003 it was agreed to deepen economic integration with the formation of the ASEAN Economic Community (AEC), to create a unified market and production base via a free flow of goods, services, foreign direct investment, skilled labor, and a freer flow of capital.<sup>1</sup>

In assessing the success or shortfall of the AEC to date, benchmarks are important. The “cup is half-full” when the achievements are measured against the backdrop of 1992. The “cup is half-empty” when the shortfalls are measured against what is promised in the AEC Blueprint of objectives and strategic actions and measures. In going forward, a SWOT analysis of ASEAN's current strengths, weaknesses, opportunities, and threats are shown below:

**ASEAN's strengths.** Strategically located in dynamic Asian region; generally robust economic growth; good macroeconomic fundamentals (especially among Indonesia, Malaysia, Philippines, Singapore, Thailand and Viet Nam, known as ASEAN6); market of 600 million people; abundance of natural resources and biodiversity; wide-ranging productive capabilities (in agriculture, manufacturing, and services); diversified exports by destination and product; mostly young, growing populations and expanding middle class; strong foreign direct investment (FDI) with strong production networks; progressive open trade and investment regimes; strong track record of regional cooperation.

**ASEAN's weaknesses.** Development gaps between and within members in income, human capital, institutions, and infrastructure and the absence of regional distributive mechanisms; disparities in good governance and the rule of law; disparities in population growth and population aging, that together with disparities in economic growth lead to large labor deficits and surpluses among countries that spurred cross-border illegal migration; slow decision making and even slower implementation of AEC commitments due to need for consensus building and slow progress in domestic reforms; weak ASEAN Secretariat with inadequate human and financial resources; weak links between ASEAN and subregional programs such as the Greater Mekong Subregion (GMS) and ASEAN growth triangles.

**ASEAN's opportunities.** Central strategic location, with high market potential in the PRC and India; strong historical, cultural links throughout Asia; strong economic links with ASEAN+1 FTA markets in Australia, New Zealand, the PRC, India, Japan and the Republic of Korea; potential development of region-wide FTA with the PRC, Japan, the Republic of Korea, India, Australia and New Zealand (RCEP); and rapidly rising middle class; deep manufacturing and technology links with Northeast Asia; financial cooperation with PRC–Japan–Republic of Korea in

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<sup>1</sup> The AEC was complemented by the ASEAN Political–Security Community and the ASEAN Socio–Cultural Community.

reserve pooling through the multilateralized Chiang Mai Initiative (CMIM); and surveillance through ASEAN+3 Macroeconomic Research Office (AMRO).

**ASEAN's threats.** Political–security conflicts in Asian region arising from unresolved intra- and extra-regional territorial disputes; vulnerability of export-dependent economies to external shocks from US and Europe; rise of the PRC and India overshadow ASEAN relevance; lack of effective regional cooperation on climate change, water-energy-food security, and disaster management (drought, floods, earthquakes, volcanic eruptions).

## 2. ASEAN ECONOMIC INTEGRATION IN THE 1980S–1990S

The economic literature lists several benefits of economic integration<sup>2</sup>, 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, investment and labor, and increased competition leading to improved efficiency and innovation.

### 2.1 Factors Pushing or Impeding ASEAN Economic Integration

Economic integration in ASEAN, as elsewhere, has both political and economic objectives.

**Geopolitical factors favoring regional cooperation.** The political–security environment in Southeast Asia in the 1960s and 1970s led to the desire to cooperate for regional peace and security: there were territorial disputes among several Southeast Asian countries; the Cold War united the ASEAN founding market economies (Indonesia, Malaysia, Philippines, Singapore, and Thailand) against communism, while the rest of Southeast Asia was under different political and economic systems. Brunei Darussalam joined after gaining political independence, while Cambodia, Lao PDR, Myanmar and Viet Nam joined following the end of the Cold War. ASEAN provided the security backdrop for individual countries to pursue their national economic development goals.

The so-called “ASEAN Way” contributed to the early success of the regional grouping, as it focused heavily on building confidence and trust among neighbors rather than legalistic structures and styles. There was a policy of non-intervention in domestic affairs, there was no hegemon, the ASEAN Secretariat was kept small so that there was minimal discomfort with supranationality, and cooperation and integration was pursued not according to any pre-decided blueprint but at a pace that all members would be comfortable with.

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<sup>2</sup> See Jovanovic (2011) for an overview.

**Initial economic diversity an impediment to regional integration.** As shown in Table 1, ASEAN members show wide diversity in land and population size, level of economic development and per capita income, and openness to international trade and investment. This diversity gave rise to differing perceptions of benefits and costs of economic integration. Larger economies (particularly Indonesia) felt less need to achieve economies of scale through trade openness, while perceiving that the more competitive smaller ASEAN economies (particularly Singapore) would gain more with free entry into an integrated regional market.

**Table 1: ASEAN—Differences in Size, Level of Development, and Trade and FDI Dependence, 2011**

	Brunei Darussalam	Indonesia	Malaysia	Philippines	Singapore	Thailand	Cambodia	Lao PDR	Myanmar	Viet Nam
Population (million)	0.4	237.7	29.0	95.8	5.2	67.6	14.5	6.4	60.4	87.8
Land area (thous. sq km)	5.8	1860.4	330.3	300.0	0.7	513.1	181.0	236.8	676.6	331.1
GDP (\$ billion)	16.3	846.8	287.9	224.3	259.9	345.8	12.8	8.2	52.8	123.3
GDP per capita (\$)	38702	3563	9941	2341	50130	5116	879	1279	875	1403
GDP per capita (PPP-adjusted)	52059	4736	15955	4289	60744	8907	2287	2825	1393	3440
Merchandise trade (\$ billion)	14.8	380.9	415.7	111.8	775.2	458.9	12.8	4.0	14.9	199.6
Trade/GDP ratio (%)	90.8	45.0	144.4	49.8	298.3	132.7	100.0	48.8	28.2	161.9
Inward FDI stock (\$ billion)	12.5	173.1	114.6	27.6	518.6	139.7	6.9	2.5	9.1	72.8
Inward FDI stock/GDP ratio (%)	76.2	20.5	41.1	12.3	203.8	40.4	53.4	32.2	16.9	60.3

ASEAN = Association of Southeast Asian Nations; FDI = foreign direct investment; GDP = gross domestic product; PPP = purchasing power parity.

Source: Compiled from ASEAN (2013) and UNCTAD (2012).

**Initial similar production and export structures an impediment to regional integration.**

Economies that are complementary at the outset of economic integration face less resistance since there would be limited competition among them, while economies that are in competition at the outset would face more resistance, as economic restructuring would be painful. However, the gains from economic integration would also be larger with improved economic efficiency from reforms and resource reallocations. Likewise, economies that are already open and globalized will benefit less from economic integration while economies that are closed will face painful adjustments from trade and investment liberalization but will enjoy efficiency gains.

Initially there was limited trade among the Southeast Asian countries (except with Singapore which functions as the regional entrepôt), since they exported similar natural resource products (such as rubber, palm oil, and metals) due to similar natural endowments and labor-intensive manufactures due to similar low technological capability. Hence they competed with each other for markets in the developed countries. With the rise of production networks in the region since the late 1980s and consequent rapid growth in intra-industry trade in parts and components, economic complementarity in manufactures developed among the ASEAN economies.

**Pressure to be competitive with transition to outward-looking development strategies.** The pursuit of import substituting industrialization from the 1960s to the 1980s by the ASEAN economies (except Singapore which maintained a free trade regime because of its entrepôt role) discouraged trade and investment liberalization to



build a regional market. However, a rapidly globalizing world and realization of the limits of import substitution led to the adoption of outward-looking development strategies through unilateral economic reforms. As such, regional economic integration became a more acceptable idea by the end of the 1980s.

**External pressures toward economic integration.** From the late 1980s, external developments were pressuring ASEAN to move toward regional economic integration to compete effectively for global markets and investments. First, regional competition prepared ASEAN industries for the more liberal global trading regime following the conclusion of the Uruguay Round in December 1991 and the reorganization of the General Agreement on Trade and Tariffs (GATT) into the World Trade Organization (WTO). Second, an ASEAN regional market overcame the threat to market access and FDI from the emerging European Single Market and the North American Free Trade Area (NAFTA). ASEAN had an integrated market size of 360 million to attract investments, and with economies of scale also led to a rational allocation of resources and increased efficiency in production. These led to the decision to establish AFTA, AFAS, and AIA in the 1990s.

A subsequent perceived external “threat” from the economic rise of the PRC and to a lesser extent of India, led to the decision to form the AEC in 2003.<sup>3</sup> Both the PRC and India are large countries with huge domestic markets, while ASEAN comprises 10 small fragmented markets, unless an ASEAN regional market could be developed. An integrated ASEAN market as well as integration with the rest of East Asia and beyond, would enable ASEAN to respond more effectively to both the challenges and opportunities of the PRC and India.<sup>4</sup>

ASEAN centrality is traditionally premised on ASEAN being a neutral platform for the major powers to meet so as to avoid the dominance of a single power within the East Asia region. In the 1990s, with the rise of the PRC and India, the idea of ASEAN centrality took hold, with the notion of an ASEAN-led regional architecture in which the region’s economic (and political–security) relations with the wider world are conducted with the interest of the ASEAN community in mind.

## 2.2 Market-Driven Integration through Production Networks

International and regional production networks are market-driven and involve the breaking up of production processes into fragmented segments that can be carried out in different cross-border locations and eventually coordinated for assembly into final products. Production networks make use of each location’s advantages to boost productivity and cut costs, while bolstering investment and technological transfer. The development of production networks has been facilitated by free trade agreements (FTAs) that encourage inward FDI by multinational corporations (MNCs). Factors in the rapid growth of production networks in East Asia include the following: First, wide regional differences in wage and labor productivity levels, resulting in different competitive cost locations for different parts of the value chain. Second, ASEAN countries increasingly adopted outward oriented development strategies resulting in

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<sup>3</sup> ASEAN commissioned the 2003 McKinsey Competitiveness Study that found that ASEAN had lost to the PRC its competitive edge in labor costs and premier location for foreign direct investment.

<sup>4</sup> As the PRC develops and experiences rising incomes it provides a huge market for ASEAN exports of goods and services, particularly for natural resource products and tourism. Also, as the PRC experiences rising wages (particularly on the east coast) and moves up the technology ladder, lower cost ASEAN countries (including Indonesia, Philippines, Thailand, and CLMV) have become major beneficiaries of FDI spillovers.

trade and investment liberalization unilaterally and regionally under the FTAs. Third, cross-border trade flows were facilitated by improvements in customs administration and availability of efficient trade infrastructure and logistics that result in lower production and logistics costs. Production networks are usually found in industries with long value chains, such as electronics and electrical machinery, automotives, and textiles and garments.

The East Asian fragmentation of manufacturing production and export appears as follows: the PRC, Japan, and the Republic of Korea are home countries for production networks, with the PRC increasingly functioning as the major assembly base (factory of the world). The ASEAN countries of Malaysia, Philippines, Singapore, and Thailand encourage inflows of MNC investments, successfully absorb new production technologies and develop local supporting industries, and became major exporters of machinery parts and components. The success of these ASEAN economies led to a second wave of production networks to Indonesia and CLMV, as they are able to absorb the relocation of labor intensive segments and enter international markets requiring only a limited range of skills.

Table 2 shows the growth in production network trade in parts and components and final assembled products between 1992–1993 and 2006–2007, accounting for 66.1% of ASEAN exports and 64.0% of ASEAN imports, with wide variations among ASEAN countries.

**Table 2: East Asia: Share of Production Network Manufacturing Trade, 1992–1993 and 2006–2007 (%)**

	Parts & components		Final assembly		Total network products	
	1992–1993	2006–2007	1992–2003	2006–2007	1992–2003	2006–2007
<b>Exports</b>						
East Asia	20.2	34.1	31.6	26.2	51.8	60.3
Japan	23.9	34.4	44.5	32.6	68.4	67.0
Developing East Asia	17.3	34.0	21.8	24.5	39.1	58.5
PRC	7.4	25.6	13.7	26.2	21.1	51.8
Hong Kong, China	15.8	33.3	18.0	17.8	33.8	51.1
Taipei, China	24.7	44.2	17.6	21.6	42.3	65.8
Korea, Rep. of	18.1	44.2	22.2	25.4	40.3	69.5
ASEAN	22.7	44.2	34.1	21.9	56.8	66.1
Indonesia	3.8	21.5	5.6	16.8	9.3	38.4
Malaysia	27.7	53.6	40.7	25.1	68.4	78.8
Philippines	32.9	71.7	20.5	15.6	53.4	87.3
Singapore	29.0	49.3	45.9	17.2	74.9	66.5
Thailand	14.1	29.9	29.0	33.0	43.1	62.9
Viet Nam		11.0		7.6		18.5
<b>Imports</b>						
East Asia	27.2	42.1	17.2	17.8	44.4	59.9
Japan	19.3	29.9	19.3	21.9	38.6	51.7
Developing East Asia	29.0	44.2	16.7	17.1	45.8	61.3
PRC	20.4	44.0	14.0	19.8	34.4	63.7
Hong Kong, China	24.1	48.5	16.5	13.5	40.6	62.1
Taipei, China	29.5	38.9	18.0	16.8	47.5	55.7
Korea, Rep. of	30.1	31.9	14.6	17.4	44.7	49.3
ASEAN	36.0	47.9	18.4	16.1	54.4	64.0
Indonesia	27.0	21.8	9.2	15.8	36.1	37.7
Malaysia	40.5	50.0	20.2	22.0	6.7	72.0
Philippines	32.6	61.3	15.0	17.4	47.6	78.6
Singapore	39.9	60.4	21.9	17.3	61.8	77.7
Thailand	30.6	36.1	15.6	12.4	46.2	48.5
Viet Nam		19.1		9.7		28.8

ASEAN = Association of Southeast Asian Nations; PRC = People's Republic of China.  
Source: Athukorala (2010).

ADB (2007)<sup>5</sup> finds over 70% of intra-East Asian trade comprises trade in parts and components which are then assembled into final goods and exported to the rest of the world, particularly the United States (EU) and the EU. This highlights the vulnerability of ASEAN exports to external shocks such as the US and EU crises.

Although production networks are essentially market-driven, FTA trade and investment liberalization and facilitation have encouraged MNCs to locate multi-plants in the ASEAN region, the most apparent being in the electronics and automotive sectors. While studies have shown that the utilization of ASEAN preferential tariffs has been low, improvements in ASEAN customs, standards harmonization, transport and logistics, and investment liberalization, facilitation, and protection have facilitated trade and FDI flows. More particularly, regional trade and investment liberalization and

<sup>5</sup> See ADB (2007) for detailed discussions.

facilitation programs have also resulted in the spread of production networks from the more developed ASEAN countries to the less developed CLMV.

## 2.3 FTA Driven Economic Integration in the 1990s

AFTA entails intra-ASEAN tariff liberalization and elimination under the Common Effective Preferential Tariff (CEPT) scheme. A customs union with common external tariffs was ruled out in view of the marked differences in most favored nation (MFN) tariff levels among ASEAN economies, particularly between Singapore and the rest. Initially, tariffs were to be brought down to the 0-5% range within 15 years.<sup>6</sup> Following on economic integration trends elsewhere, where free trade in goods was accompanied by free trade in services and investment liberalization, AFTA was complemented by the 1995 AFAS and the 1998 AIA agreement. The implementation of AFTA, AFAS, and AIA are discussed in later sections.

In 1996 the ASEAN Industrial Cooperation (AICO) scheme was introduced to promote joint manufacturing between ASEAN-based companies.<sup>7</sup> The scheme requires the participation of at least two companies in two ASEAN countries and at least 30% national equity.<sup>8</sup> AICO products enjoy immediate AFTA end-tariff rates of 0-5% as well as local content accreditation and investment incentives offered by ASEAN national authorities. AICO has successfully promoted production networks in automotive and electronics industries.

## 3. THE AEC—RATIONALE, PROGRESS, AND SHORTFALLS

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### 3.1 Rationale and Process Towards AEC

In October 2003, ASEAN decided to establish the AEC by 2020 but advance it to 2015 in January 2007 (with a longer time line of 2018–2020 for CLMV). The AEC is a highly ambitious effort at deep integration which includes factors of production as well as a dispute settlement mechanism. It draws on the 1997 ASEAN Vision 2020<sup>9</sup> and the recommendations of the ASEAN High Level Task Force.<sup>10</sup> In November 2004 the

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<sup>6</sup> The CEPT scheme for AFTA was agreed for implementation without the exhaustive feasibility studies and public debate that characterized the formation of NAFTA, and while the NAFTA document contained almost 400 pages, the AFTA document contained only six pages.

<sup>7</sup> ASEAN had experimented with several industrial cooperation schemes in the 1970s and 1980s without much success.

<sup>8</sup> This national equity requirement was waived following the outbreak of the Asian financial crisis and the waiver remained until the end of 2005.

<sup>9</sup> ASEAN Vision 2020 agreed by ASEAN Heads of State in Kuala Lumpur on 15 December 1997.

<sup>10</sup> Two months before the November 2002 Phnom Penh Summit, ASEAN economic ministers had agreed to form a High Level Task Force on ASEAN Economic Integration to recommend measures for deepening

Vientiane Action Program laid down the goals and strategies for bringing the ASEAN Community to reality. In November 2007, the AEC Blueprint outlining various measures and strategic schedules for implementation was adopted. In April 2009 the Declaration on the Roadmap for the ASEAN Community (2009–2015) agreed to an accelerated timetable for the realization of the AEC. In April 2012 ASEAN agreed to redouble efforts and set priority activities and concrete key actions to realize the AEC by 2015.

The AEC has four pillars that aim to “transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy” (ASEAN 2008). It has often been inappropriately compared to the EU Single Market. But the AEC is neither a customs union (with common external commercial policy) nor a full common market (with free mobility of capital and labor and some policy harmonization).

The creation of a single market and production base should allow ASEAN to benefit from economies of scale and efficiency in production network processes. ASEAN could leverage on economies at different levels of economic development to provide complementary locations for production networks. An integrated market and production base would clearly boost intra-regional trade and investment flows while an ASEAN consumer market of over half a billion would be attractive for investors. The ASEAN High Level Task Force recommended the following for the AEC:

- (i) Accelerate current ASEAN economic integration programs, laying down clear timelines for specific measures in the areas of tariffs, non-tariff measures, customs, standards, services, investments, intellectual property rights, and finance.
- (ii) Designate 12 priority sectors<sup>11</sup> for accelerated integration with the coverage of each sector broad enough to account for a substantial portion of intra-ASEAN trade and potential to maximize the complementarities among ASEAN economies and serve as a catalyst for expediting the integration process. Priority sectors identified are agro-based products, fisheries, rubber-based products, wood-based products, textiles and apparel, automotives, electronics, e-ASEAN, air transport, healthcare, logistics, and tourism.
- (iii) Adopt an “ASEAN minus X” formula in integrating the priority sectors. That is, two or more ASEAN members may initiate and participate in intra-ASEAN economic arrangements, while other ASEAN members may join when they are ready to do so.
- (iv) Improve the CEPT rules of origin (ROO), including making the ROO more transparent, predictable and standardized. Ensure transparency on non-tariff measures (NTMs), eliminate NTMs that are barriers to trade, establish an ASEAN database on NTMs, set clear and definitive work program for removal of NTBs, adopt the WTO agreements on Technical Barriers to Trade, Sanitary and Phytosanitary and Import Licensing Procedures and develop implementation guidelines appropriate for ASEAN.
- (v) Establish new institutional mechanisms, including a legal unit on trade disputes in the ASEAN Secretariat, a compliance monitoring body for peer adjudication, and an impartial dispute settlement mechanism.

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the region’s economic integration beyond AFTA. This was in response to the McKinsey study commissioned by ASEAN that had concluded that ASEAN had great economic promise and potentially large market but was losing out to others as an investment destination because of its market fragmentation.

<sup>11</sup> The 12th priority sector, logistics, was added only in 2007.

### 3.2 Quantifying the Expected Benefits of the AEC

A CGE model of the AEC by Plummer and Chia (2009),<sup>12</sup> incorporates assumptions on the complete elimination of tariffs and NTBs, the liberalization of five service sectors, AEC-induced changes in FDI, and a 5% reduction in trade costs (Table 3). First, ASEAN economic welfare under the AEC should rise by 5.3% relative to the baseline.

**Table 3: Welfare Gains of the AEC in 2015**

	<b>AFTA</b>	<b>AEC</b>	<b>AFTA</b>	<b>AEC</b>
	\$ billion, 2004 price		Percent of baseline GDP	
Brunei Darussalam	0.2	0.5	2.6	7.0
Indonesia	1.0	27.6	0.2	6.2
Malaysia	2.7	5.7	1.4	3.0
Philippines	0.9	4.5	0.6	3.2
Singapore	2.6	15.1	1.6	9.7
Thailand	1.6	12.2	0.6	4.9
Cambodia	0.3	0.6	2.7	6.3
Lao PDR	0.0	0.2	0.6	3.6
Myanmar	0.0	0.6	0.3	4.4
Viet Nam	0.9	2.4	1.1	2.8
<b>ASEAN total</b>	<b>10.1</b>	<b>69.4</b>	<b>0.8</b>	<b>5.3</b>

AEC = ASEAN Economic Community; AFTA = ASEAN Free Trade Area; ASEAN = Association of Southeast Asian Nations; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.  
Source: Plummer and Chia (2009).

All ASEAN countries benefit, although some benefit more than others, either absolutely or relative to GDP size. Second, to estimate the direct effects of behind-the-border measures and best practices spread by means of AEC, the projections suggest that competition policy alone could raise per capita GDP by 26–38% in ASEAN6. And by creating opportunities for production networks and spreading best practices that boost productivity, AEC should help CLMV converge with ASEAN6. Third, the net benefits of the AEC would be larger than the estimated 5.3% increase in ASEAN economic welfare, due to gains that have not been quantified by the CGE model. These include lower cost of capital due to freer movement of capital and improved financial systems; efficiency gains from freer movement of skilled labor; and greater macroeconomic stability due to the conservative macroeconomic policies necessary to support the AEC.

An alternative simulation by ERIA (2012)<sup>13</sup> assumes all tariffs are eliminated, there is a 20% in tariff equivalent of service trade barriers, and also a 20% reduction in time cost to export and import (improved trade facilitation). The cumulative impact of the policy change on GDP, exports, imports relative to baseline over the 2011–2015 periods as measured by 2015 shows the following: First, the impact on GDP of complete tariff elimination is largely marginal for most ASEAN states except Cambodia and to a lesser extent Viet Nam and Lao PDR, as CEPT tariffs were already very low in the other ASEAN states. Second, the biggest jump in GDP growth rates for Indonesia, Malaysia, Philippines, Singapore, Thailand and Viet Nam are from service trade liberalization. Third, reduction in time costs due to improved trade facilitation, infrastructure, and logistics has significant positive impact on GDP, especially for Lao PDR, Cambodia

<sup>12</sup> Empirical studies estimating the effects of FTAs usually focused on tariff liberalization as it is the easiest trade barrier to identify. However, the AEC also includes liberalization of non-tariff barriers and behind-the-border measures affecting goods trade, as well as liberalization of services trade and investment.

<sup>13</sup> The full report has not been released by ERIA, due to some sensitivities.

and Viet Nam. Finally, the CGE model underestimates economic effects as it fails to fully capture the effects of productive efficiency, technology improvements, and even possibly the extent of improvement in investor expectations as a result of reform efforts for economic integration.

### 3.3 The AEC Blueprint and Progress

The AEC's four pillars and core elements are shown in Table 4. The AEC Blueprint sets out the measures to be taken and the schedule for implementation.

**Table 4: AEC Blueprint—Four Pillars and Core Elements**

Pillars	Core Elements
A. Single Market and 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 labor 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

AEC = ASEAN Economic Community; ASEAN = Association of Southeast Asian Nations; SME = small or medium-sized enterprise  
Source: ASEAN Secretariat (2008).

#### 3.3.1 AEC as single market and production base

The EU single market is an area with free movement of goods, services, labor and capital. However, cross border freedoms are not sufficient to ensure foreign suppliers have access equal to that of domestic suppliers<sup>14</sup> and national treatment behind the border is necessary. However, even full national treatment is inadequate to remove all measures that inhibit cross border trade or factor movements. Hence the need for harmonization of the relevant laws, including competition law and intellectual property rights, and mutual recognition of product standards and labor market qualifications.

<sup>14</sup> See Lloyd (2007) for detailed explanation. Under the WTO, national treatment has been applied to a wide range of government taxes, charges and product standards that provide discrimination against foreign goods. Exceptions to national treatment in the WTO include subsidies and government procurement of goods.

In the AEC, the single market is committed to free flow of goods, services, and skilled labor and freer flow of capital for priority sectors by 2010 “to the extent feasible and agreeable to all member countries” and a goal of national treatment for all service sectors is in the Roadmap for Integration of ASEAN. On the harmonization of standards and technical regulations, working groups have been established in some priority sectors to implement standard-related measures while steps have been taken to set up a common intellectual property regime.

**Progress in goods trade liberalization.** AFTA was implemented in 1993 and succeeded by ATIGA (ASEAN Trade in Goods Agreement) in May 2010, the latter to consolidate and synergize various provisions on trade in goods into a single document. AFTA’s Common Effective Preferential Tariff (CEPT) scheme for tariff reduction has an Inclusion List (IL), Temporary Exclusion List (TEL), Sensitive List (SL), and General Exclusion List (GEL). The TEL would be eliminated through five annual transfers to the IL, completed by 2000 for ASEAN6 and by 2003 for CLMV. The SL comprises unprocessed agricultural products with tariff liberalization delayed to 2010 for ASEAN6 and 2013–2017 for CLMV. The GEL permanently excludes certain products from liberalization for reasons of national security, protection of human, animal or plant life and health, and articles of artistic, historic and archaeological value.

Several changes have been made to the initial CEPT tariff reduction/elimination schedule. First, the time frame to reach the 0–5% target was shortened. Second, it was agreed to further reduce tariffs from 0–5% level to zero level. Third, for priority sectors, the target dates for eliminating tariffs were advanced. Table 5 shows that from January 2010, all tariffs for CEPT ILs of ASEAN6 have been eliminated, representing 99% of ASEAN total tariff lines and the average tariff brought down to 0.9%. For the CLMV countries, tariff levels were down to 0–5% level by 2010 and to be eliminated by 2015. The CEPT Inclusion List coverage ranges from a high of 98.3% for Cambodia to a low of 78.4% for Indonesia.<sup>15</sup> There is difficulty in eliminating tariffs on the SL products, particularly rice and sugar, because of national food security concerns in some ASEAN countries.

*Rules of origin (ROO).* Initially AFTA had a simple ROO criterion of a 40% regional value content (RVC). But in response to feedback facing difficulties in qualifying under the existing ROO, AFTA introduced additional ROO options using the change in tariff classification (CTC) and the product specific process rule; abolished the free-on-board (FOB) Value in the ASEAN Certificate of Origin (CO) Form D; and implemented the Pilot Project for a Regional Self Certification System by Brunei Darussalam, Malaysia, Singapore, and Thailand. The ROO has also been made more user-friendly with back-to-back certificate of origin and third party invoicing. Remaining issues with ROOs include arbitrary classification of origin resulting from differences in tariff classification among countries caused by slow adoption of the ASEAN harmonized tariff classification and the “noodle bowl” effect in the absence of a common template for the numerous ASEAN+1<sup>16</sup> and bilateral FTAs of ASEAN countries.

*Removal of non-tariff barriers (NTBs).* With the elimination of most tariffs, NTBs emerge as a serious trade impediment. Not all non-tariff measures (NTMs) are NTBs. The latter include import quotas and anti-dumping actions as well as technical,

<sup>15</sup> Inclusion lists for other ASEAN countries are 97.5% for Singapore, 94% for Thailand, 92.89% for Brunei Darussalam, 87.39% for Malaysia, 79.61% for the Philippines, 99.3% for Myanmar, 96.6% for Viet Nam, 95.2% for Lao PDR, and 98.3% for Cambodia.

<sup>16</sup> ASEAN+1 FTAs have been signed between ASEAN and the PRC, Japan, Republic of Korea, India and Australia-New Zealand. Negotiations are underway on FTAs with the EU and the Gulf Cooperation Council. There is no common template in the various ASEAN+1 FTAs.



administrative, health, and safety regulations usually imposed for quality assurance and safety standards, but could also have protectionist effects. The CEPT agreement had provisions for elimination of quantitative restrictions immediately upon application of CEPT concessions for that product and phasing out of all other NTBs within five years of the enjoyment of such concessions. It was later decided that all quantitative restrictions and NTBs be eliminated beginning in January 1996. In reality, removal of NTBs has been slow in ASEAN, partly because it took considerable time for ASEAN to compile and update its NTB database.<sup>17</sup> As shown in Table 5, NTBs were supposed to be eliminated by 2010, except for the Philippines (by 2012) and for CLMV (by 2015 with flexibility to 2018 for some products). While Myanmar, Indonesia, and Philippines were countries applying most of the NTBs, Cambodia and Thailand were the least NTB-restrictive countries.

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<sup>17</sup> It is a difficult process to identify all the non-tariff measures (NTMs) in each country and at sub-country level, especially as not all NTMs are barriers to intra-ASEAN trade.

**Table 5: AEC—Tariff and NTB Reduction and/or Elimination Schedule**

	2008–2009	2010–2011	2012–2013	2014–2015
Tariff reduction	Complete tariff reduction to 0–5% for all IL products for Lao PDR and Myanmar (2008)	Complete tariff reduction to 0–5% for all IL products for Cambodia (2010)		
Tariff elimination	Integrate products outside CEPT Scheme according to CEPT Agreement (2008)			
	Eliminate import duties on 60% of all IL products except for those phased in from SL and HSL for Lao PDR and Myanmar (2008)	Eliminate import duties on 60% of all IL products except for those phased in from SL and HSL for Cambodia (2010)		
	Eliminate import duties on 80% of all IL products except for those phased in from SL and HSL for ASEAN-6 (2007)	Eliminate import duties on 80% of all IL products except for those phased in from SL and HSL for Viet Nam (2010)	Eliminate import duties on 80% of all IL products except for those phased in from SL and HSL for Lao PDR and Myanmar (2012)	
		Eliminate tariffs on all products, except for those phased in from the SL and HSL for ASEAN6 (2010)		Eliminate tariffs on all products, except for those phased in from the SL and HSL for CLMV 2015 with flexibility on some sensitive products up to 2018
	Eliminate import duties on products in the PIS for ASEAN6 (2007)		Eliminate import duties on products in the PIS for CLMV (2012)	
	Elimination of duties for 1st and 2nd tranche of ICT products for CLMV according to the Framework Agreement on e-ASEAN (2008 for 1st tranche and 2009 for 2nd tranche)	Elimination of duties for 3rd tranche ICT products for CLMV according to Framework Agreement on e-ASEAN (2010)		
		Reduce tariffs on SL products to 0–5% for ASEAN6 (2010)	Reduce tariffs on SL products to 0–5% for Viet Nam (2013). For sugar, Viet Nam shall reduce tariffs to 0–5% by 2010	Complete phase in of remaining products in SL into CEPT Scheme and reduce tariffs on them to 0–5% (2015 Lao PDR and Myanmar, 2017 Cambodia)
		Complete tariff reduction schedule for HSL to the agreed end-rate		

NTB elimination	Abide by the commitment of a standstill and rollback on NTBs effective immediately			
	Enhance transparency by abiding to the Protocol on Notification Procedure and setting-up an effective Surveillance Mechanism			
		Eliminate NTBs for ASEAN5 (2010)	Eliminate NTBs for Philippines (2012)	Eliminate NTBs for CLMV (2015) with flexibility to 2018 for some sensitive products
NTB elimination	Abide by the commitment of a standstill and rollback on NTBs effective immediately			
	Enhance transparency by abiding to the Protocol on Notification Procedure and setting-up an effective surveillance mechanism			
		Eliminate NTBs for ASEAN5 (2010)	Eliminate NTBs for Philippines (2012)	Eliminate NTBs for CLMV (2015) with flexibility to 2018 for some sensitive products

AEC = ASEAN Economic Community; ASEAN = Association of Southeast Asian Nations; CEPT = Common Effective Preferential Tariff; CLMV = Cambodia, Lao PDR, Myanmar, Viet Nam; HSL = Highly Sensitive List; = ICT = information and communication technology; IL = Inclusion List; Lao PDR = Lao People's Democratic Republic; NTB = non-tariff barriers; PIS = priority integration sector; SL = Sensitive List.  
Source: ASEAN (2012).

**Progress in goods trade facilitation.** ASEAN is not a customs union and border procedures and inspections are necessary and pervasive. The ASEAN Trade Facilitation Framework and its work program have been adopted to address issues such as integrating customs procedures, establishing the ASEAN single window (ASW) program, enhancing preferential tariff certification procedures, harmonizing standards, and conformance procedures.

**Customs improvements.** Customs regulations and procedures give rise to arbitrary and sometimes corrupt application in ASEAN countries and add to business transaction costs. Improvements are via the 1983 ASEAN Code of Conduct on Customs, the 1997 ASEAN Agreement on Customs,<sup>18</sup> the 2003 ASEAN Customs Valuation Guide (modeled after the WTO customs valuation agreement), the 2003 ASEAN Post-Clearance Audit Manual, the Green Lane system for customs clearance of goods from

<sup>18</sup> The code aims to establish a common system for the valuation of traded goods for customs purposes, customs classifications and tariff nomenclatures; simplify and harmonise customs procedures; and provide for the right of affected persons to appeal decisions by customs authorities

ASEAN, and the ASEAN Harmonized Tariff Nomenclatures (AHTN) system to provide a common system to classify and designate all goods for customs purposes. The ASW program, requiring prior establishment of national single windows (NSW) aims to reduce transaction costs by speeding up clearance of shipments and release of goods by customs authorities. However, the ASW program has fallen behind its 2008 deadline, as several countries have not fully established their national single windows.<sup>19</sup> The technical and legal foundations of the ASW program are being set up for modest implementation by 2015.

*Technical barriers, product standards and mutual recognition.* To minimize business transaction costs, national standards and technical regulations on products are either harmonized across ASEAN or mutual recognition arrangements (MRAs) adopted. ASEAN's wide development gap poses an impediment. The 1992 ASEAN Consultative Committee for Standards and Quality (ACCSQ) focused on 4 main activities of harmonizing national standards, mandatory technical requirements, conformity assessment procedures, and technical regulations. In 1997 ASEAN designated some 20 priority products for standards harmonization (using international standards); in 1999 it agreed to align safety standards for 71 electrical appliances for commercial and household use and electromagnetic compatibility standards for 10 categories of scientific and other equipment. In 1998 ASEAN adopted a framework agreement on MRAs that would obviate duplicative product testing and other forms of product compliance and thus reduce delays and costs. MRAs have been reached in the electrical and electronics, cosmetics, and pharmaceutical sectors.

*Transportation and trade logistics.* Both the physical transport infrastructure and the administrative regulatory system are crucial for efficient delivery of physical goods. Interstate land and air transport are subject to bilateral agreements, and regional agreements are badly needed. In 1995 ASEAN adopted the Singapore–Kunming rail link. In 1998 ASEAN moved to remove administrative regulatory obstacles to the free movement of goods, agreeing that inspection certificates issued by one country for commercial vehicles be valid in the other countries. Also in 1998 ASEAN concluded a framework agreement to facilitate transit passage of goods, that is, to ensure that goods being transported from one ASEAN country to another through a third would not be subject to unnecessary delays, restrictions, taxation, or customs inspection in the transit country. In 1999 the ASEAN Highway Network was formalized. The 1998 Hanoi Plan of Action called for a framework and modalities by 2000 for the development of a Competitive Air Services Policy as a prelude to an ASEAN Open Sky Policy; the rapid growth of budget airlines in the region was already breaking up the monopolies of ASEAN national airlines. In November 2005 an agreement on multimodal transport was concluded.

Logistics encompasses activities from transport, warehousing, cargo consolidation, and border clearance to domestic distribution and payment systems. According to the Logistics Performance Index (World Bank 2012),<sup>20</sup> there is a wide gap in logistics

<sup>19</sup> The ASEAN6 countries are at various stages of operating their respective NSWs, but still face challenges regarding their effectiveness. For example, Indonesia needs to improve coordination among offices involved in the NSW, human resource capacity in its customs office and related agencies, and new regulations made to implement the NSW; Thailand has a coordination problem among agencies involved in the NSW; and the Philippines has problems of data standardization and business process simplification. The CLMV had until 2012 to set up their NSWs and need a huge effort to meet the 2015 AEC completion deadline.

<sup>20</sup> Among the Index's components, Malaysia and Thailand ranked poorly for customs process, Philippines and Viet Nam ranked poorly for quality of infrastructure, Indonesia ranked poorly for both customs process and quality of infrastructure and competence and quality of its logistics services. CLM have problems in all components—border control efficiency, infrastructure quality, ease of arranging competitively priced

performance among ASEAN countries, with Singapore and Myanmar at two ends of the spectrum.

**Progress in services trade liberalization.** AFAS helps lock in the unilateral liberalization measures already undertaken by ASEAN member states, and prepare them for further services liberalization in the WTO and other FTAs. AFAS requires negotiations to be conducted sector by sector, with negotiations originally based on the GATS approach of request and offer. However, difficulty in reaching consensus led ASEAN to adopt in 2004 the flexible ASEAN minus X approach whereby two or more ASEAN countries can start to negotiate services trade liberalization for specific sectors and/or subsectors, while other members could join later.

Liberalization is to be achieved through consecutive biennial rounds of negotiations, so that by 2015 substantially all restrictions would be removed. Each round of negotiation resulted in a package of commitments in each agreed sector and/or subsector and mode of supply. The general reluctance to liberalize services under Mode 3 (commercial presence) and Mode 4 (movement of natural persons) led to modifications in subsequent services negotiations, which resulted in liberalization of all limitations for Mode 1 (cross-border supply) and Mode 2 (consumption abroad) but only progressive liberalization for Modes 3 and 4.<sup>21</sup> For Mode 4, MRAs or MRA frameworks for professional qualifications have been completed in architecture, accountancy, surveying, engineering, medical practitioners, dental practitioners, and nursing. Other MRAs for professional services are to be identified and negotiations completed by 2015.

There have been five rounds of negotiations involving eight packages that cover business services, professional services, construction, distribution, education, environmental services, healthcare, maritime transport, telecommunications, and tourism. Criticisms of slow progress in services liberalization include the following: AFAS has resulted only in marginal liberalization when compared to GATS commitments;<sup>22</sup> service negotiators are extremely cautious either because of their uncertainty about the impact of liberalization and fear of the loss of regulatory control in some service sectors (such as financial services) or because of the power of domestic interests; Mode 3 liberalization envisions only a maximum of 70% of ASEAN equity share; Mode 4 liberalization is confined to movement of professionals only; and the pre-agreed flexibilities cover subsectors totally excluded from liberalization and subsectors without agreed liberalization on all the four modes of supply. In September 2005, ASEAN ministers declared 2015 as the end-date for liberalization of all services sectors.

**Progress in investment liberalization, facilitation, promotion, and protection.** The 1998 AIA agreement aims to facilitate FDI inflows and participation in global and regional production networks. It grants national treatment to ASEAN investors by 2010

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shipments, competence of logistics services, ability to track and trace consignment, timeliness in shipments of reaching destinations.

<sup>21</sup> For Mode 3, the allowed foreign equity should be not less than 52% by 2008, and 70% by 2010 for the 4 priority service sectors; not less than 49% by 2008, 51% by 2010, and 70% by 2013 for logistics services; and not less than 49% by 2008, 51% by 2010 and 70% by 2015 for other services sectors. For Mode 3, the parameters of liberalization for national treatment limitations, and limitations in the horizontal commitments for each round are set by 2009 and schedule commitments according to agreed parameters. All ASEAN countries (except Singapore) have fallen behind the liberalization goals in terms of foreign equity participation. Domestic restrictions on equity and landholdings, and licensing requirements continue to pose significant barriers to intra-regional investment in services. Since the AEC does not reach into behind-the-border issues, it is likely that these barriers will persist in the foreseeable future.

<sup>22</sup> See Deunden (2012) for a more detailed critique.

and to non-ASEAN investors by 2020, with some exceptions specified in the TEL, SL, and GEL. In 2001 the date for full realization of the AIA was advanced to 2010 for ASEAN6 and 2015 for CLMV, and differential treatment of ASEAN and non-ASEAN investors was removed. Sectoral coverage includes manufacturing, agriculture, fisheries, forestry, and mining, and services incidental to those sectors. In 2003 this was expanded to include other services such as education, healthcare, telecommunications, tourism, banking and finance, insurance, trading, e-commerce, distribution and logistics, transportation and warehousing, and professional services such as accounting, engineering, and advertising.

The extent and type of investment barriers are indicated by the TEL, SL, and GEL. The deadlines for phasing out the TELs in manufacturing were advanced to January 2003 for the ASEAN6 and Myanmar, and to January 2010 for Cambodia, Lao PDR and Viet Nam. The deadlines for phasing out TELs in agriculture, fishery, forestry, mining, and related services were 2010 for the ASEAN6 and Cambodia, 2013 for Viet Nam, and 2015 for Lao PDR and Myanmar. As with services liberalization, the ASEAN minus X formula was introduced. The GEL comprises industries and investment measures closed to FDI for reasons of national security, public morals, public health, and environmental protection.

The ASEAN Comprehensive Investment Agreement (ACIA) superseded the AIA, with the additional feature of investment protection. Although signed in 2009 it was ratified only in March 2012, due to delays by Thailand and Indonesia. ASEAN countries also delayed submission of their reservations lists even though they are required to submit within six months after their signing. In particular, the ACIA offers:

- *Investment liberalization.* Free and open investment by 2015 with MFN and national treatment for investors (with limited exceptions); reduce and/or remove restrictions to entry for investments in the priority integration sectors; and reduce and/or remove restrictive investment measures and other impediments, including performance requirements. While all ASEAN countries welcome FDI, some countries such as Indonesia and Thailand have long TELs and SLs on right of establishment and national treatment. ASEAN countries have started to consider amending regulatory regimes to support changes in rules.
- *Investment facilitation.* This entails more transparent, consistent, and predictable investment rules, regulations, policies and procedures; harmonize, where possible, investment policies to achieve industrial complementation and economic integration; streamline and simplify procedures for investment applications and approvals; promote dissemination of investment information, rules, regulations, policies and procedures; strengthen databases on investment to facilitate policy formulation; strengthen coordination among the government ministries and agencies concerned; and consult with ASEAN private sectors to facilitate investment and identify and work towards areas of complementation.
- *Investment protection.* Updated a 1987 protection agreement to provide enhanced protection to all investors and their investments; provisions on the investor–state dispute settlement mechanism; and transfer and repatriation of capital, profits, dividends, among others; provide transparent coverage of expropriation and compensation, full protection and security, and treatment of compensation for losses resulting from strife.
- *Investment promotion.* Promote ASEAN as an integrated investment area; intra-ASEAN investments, especially from the ASEAN6 to CLMV; growth and development

of SMEs as well as MNCs; promote industrial complementation and production networks among MNCs in ASEAN; joint investment missions that focus on regional clusters and production networks; and an effective network of bilateral agreements on avoidance of double taxation among ASEAN countries. ASEAN has intensified efforts through such initiatives as the linking of investment agencies' websites, development and dissemination of investment publications, and investment road shows and seminars.

**Progress with freer flow of capital.** Efforts to liberalize and integrate the financial markets through initiatives such as financial services liberalization, capital market development, and capital account liberalization have been further strengthened to support trade integration. On financial services liberalization, based on a new approach of pre-agreed flexibilities, the sixth round of negotiations was launched in May 2011. On capital market development, efforts to deepen equities markets were strengthened and new working committees on dispute resolution and enforcement, and taxation were established. The marketing and branding campaign for the ASEAN Exchanges initiative that promotes ASEAN as an asset class was launched in May 2011 and an ASEAN Bond Market Development Scorecard was developed. In line with the development of local currency bond markets, the Credit Guarantee and Investment Facility (CGIF) was established in October 2011, while the agreement for the ASEAN Infrastructure Fund (AIF) was signed in September 2011. The Chiang Mai Initiative Multilateralized (CMIM) was finalized in December 2009, providing for an enlarged \$120 billion swap arrangement.

**Progress with free flow of skilled labor.**<sup>23</sup> Factors driving skilled labor mobility in ASEAN include large disparities in wages and employment opportunities, geographic proximity and socio-cultural-linguistic environment, and disparities in educational developments. As more ASEAN countries move up the technological ladder, liberalizing trade in goods and services and in FDI would not be enough, and a larger pool of professional and skilled labor becomes necessary. Until such time when domestic educational and training institutions are able to supply the necessary high level manpower, and domestic economic growth is able to absorb this high level manpower, countries will still have to depend on foreign talent or export talent. However, even with adequate domestic supply there is still need for foreign talent to provide competition, stimulation, and synergy to improve the quality and productivity of domestic talent. Some countries like Singapore, and to a lesser extent Malaysia, regard foreign talent as an upgrading and competitive tool and have active policies to promote their inflows. Most ASEAN countries, however, have yet to move away from protecting domestic professionals and skilled workers through constitutional provisions, policies, regulations, and practices.

In The AEC Blueprint, strategic actions on free flow of skilled labor include facilitating the issuance of visas and employment passes, MRAs for major professional services, core concordance of services skills and qualifications. Enhanced cooperation for the movement of natural persons was finalized in late 2012.

*Mutual Recognition Arrangements* .MRAs are major instruments for skilled labor mobility in ASEAN. Through MRAs, ASEAN countries may recognize the education or experience obtained, requirements met, and licensing or certification granted by other ASEAN countries. However, negotiating for recognition is a complex and time consuming process given the wide differences in development levels and educational and professional standards among ASEAN countries and the role of national

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<sup>23</sup> For a more detailed discussion, see Chia (2012).

professional bodies. MRAs for professional qualifications have been completed in accountancy, engineering, medicine, dentistry, and nursing, MRA frameworks in architecture and surveying and other MRAs are expected to be identified and negotiated by the 2015 deadline.

Chia (2012) notes that effective implementation of these MRAs poses problems as market access (permission to work) is subject to domestic rules and regulations. Rules and regulatory frameworks that constrain and impede skilled labor mobility include requirements and procedures for employment visas and employment passes, constitutional and legal provisions reserving jobs for nationals, policies that impose numerical caps on foreign professionals and skills in sectors and occupations, economic and labor market tests that constrain employment of foreigners and require them to be replaced by locals within a stipulated period, language proficiency requirements, and licensing regulations of professional bodies. National sensitivities to the migration issue have prevented much effective cooperation to date.

### 3.3.2 AEC as a competitive economic region

This AEC pillar has several behind-the-border action areas to reinforce ASEAN competitiveness. These cover:

**Competition Policy.** Several initiatives have been undertaken, including the formation of an ASEAN Experts' Group on Competition, ASEAN Regional Guidelines on Competition Policy, and a Handbook on Competition Policy and Laws in ASEAN for Business. The guidelines provide a reference on country experiences and best practices at the international level, while the handbook provides basic notions of substantive and procedural competition law applicable in ASEAN countries.

**Intellectual Property Rights (IPR).** The ASEAN countries' position is primarily that of developing country users, although Singapore has significant interest in intellectual property (IP) protection for its high tech and biomedical sectors, while other ASEAN countries are concerned with the protection of their traditional and indigenous cultures, medicines, and plants. The development of IP and IPR is crucial to build ASEAN as an innovative and competitive economic region. Hence in August 2011, ASEAN endorsed its IPR Action Plan 2011–2015. ASEAN also collaborated with Dialogue Partners and international organizations to enhance capacity building in IP. Conflicts of interest among ASEAN countries are rare and the main conflicts are enforcing the IPR of developed countries and foreign MNCs in regard to manufactured branded products, patented medicines, information technology (IT) software, and online music and movies.

**Infrastructure Development.** Transportation and IT infrastructure are essential for the movement of goods, capital, labor, people, and ideas among ASEAN countries. The Brunei Action Plan adopted in 2010 contains strategic actions to be implemented in 2011–2015 toward the realization of AEC as well as new priorities under the Master Plan on ASEAN Connectivity. The signing of the ASEAN Multilateral Agreement on the Full Liberalization of Passenger Air Services and its protocol provided a framework for the full realization of ASEAN Open Skies. To facilitate ASEAN shipping services, the Strategy Toward the Integration of an ASEAN Single Shipping Market was developed. The stocktaking of road inventory of all national route components of the ASEAN Highway Network to strengthen the ASEAN regional infrastructure was completed. The ASEAN ICT Master Plan 2015 was adopted in January 2011, and a study on the adoption of an ASEAN Technical Architecture Framework for e-commerce interoperability was completed. The ASEAN Plan of Action on Energy Cooperation (APAEC) 2010–2015 consists of seven key areas of cooperation to enhance energy security, accessibility, and sustainability for ASEAN: ASEAN Power Grid, Trans-ASEAN Gas Pipeline, Coal and



Clean Technology, Renewable Energy, Energy Efficiency and Conservation, Regional Energy Policy and Planning, and Civilian Nuclear Energy. The necessary domestic legislation has yet to be enacted for the ASEAN Framework Agreement on Multilateral Transport, the ASEAN Framework Agreement on Inter-State Transport, the ASEAN Multilateral Agreement on Full Liberalization of Passenger Air Services, the ASEAN Single Shipping Market, and the ASEAN Interconnection Projects. In 2010 the Master Plan on ASEAN Connectivity was adopted, with an estimated \$60 billion annual infrastructure investment needed for the 2010–2020 period. The ASEAN Infrastructure Fund commenced operation in May 2012.

A major challenge in ASEAN infrastructure development is coordinating the various national needs with the regional vision and plans so as to obviate costly overlaps and missing links, harmonizing various national infrastructure standards, and effective monitoring of implementation of infrastructure projects so as to facilitate the flows of goods and people. As infrastructure financing needs are huge, ASEAN needs to explore various funding mechanisms and sources.

### 3.3.3 AEC with equitable economic development

The AEC Blueprint lists only two measures: SME (small or medium-sized enterprise) development targeted to narrow intra-country development gaps; and the Initiative for ASEAN Integration (IAI) targeted at narrowing the development gap between the ASEAN6 and CLMV. The 19th ASEAN Summit in November 2011 endorsed the ASEAN Framework on Equitable Economic Development (EED) as a new initiative.

**Development of small or medium-sized enterprises (SMEs).** This is necessary for equitable development through mitigating market dominance by foreign MNCs and large state-owned enterprises (SOEs) and fostering local entrepreneurship, innovation, and employment creation. SMEs in ASEAN face several challenges, including limited access to finance and technology, severe competition from SOEs and MNCs as well as SMEs from the PRC, Japan, and the Republic of Korea, weak entrepreneurial and management skills, and difficulties in coping with AEC market standards. ASEAN endorsed the Strategic Action Plan for the ASEAN SME Development (2010–2015) in August 2010. The ASEAN SME Advisory Board provides strategic policy input on SME development to the ministers and guidance on high priority matters to the ASEAN SME Working Group. Work started on the Conceptual Framework for Regional SME Development Fund. Two projects under the Strategic Action Plan have been completed. The Directory of Outstanding ASEAN SMEs seeks to promote links of SMEs to the regional and global supply chains and production networks.

**Initiative for ASEAN Integration (IAI).** The IAI serves as a platform for identifying and implementing technical assistance and capacity building programs targeted at CLMV. The ASEAN6, ASEAN dialogue partners, and the Asian Development Bank (ADB) are involved in the IAI programs. The new IAI Strategic Framework and WorkPlans I and II were endorsed to facilitate implementation of CLMV projects. The scope of priority areas has expanded beyond the initial focus on infrastructure, human resource development, ICT, and capacity building for regional integration to include tourism, poverty, and quality of life.

Vo (2012) surveyed responses on the effectiveness of the IAI and came to the following conclusions. First, CLMV countries have positive perception of the IAI programs and projects, as they are relevant to development needs and priorities of CLMV. However, better outcomes would have been realized if the IAI workplans had been better designed and implemented and there had been better financial adequacy. Second, the IAI program areas and/or projects contribute either moderately or

substantially to narrowing development gaps. Criticisms of the IAI programs focus on the inappropriateness of using a common template for CLMV, some projects are too ambitious in terms of financial resources and time available, the role of the World Bank and ADB as donors would be necessary; and IAI needs to pay more attention to institution building.

### 3.4 Measuring Progress in ASEAN Economic Integration

Growth in intra-regional trade is a common measure of the extent of trade integration achieved. However, unlike economic integration efforts elsewhere where the focus is on increasing intra-regional trade and investment shares, ASEAN's focus is on reducing barriers to intra-regional trade and investment so as to compete more effectively in the global arena.

**Intra-ASEAN Trade.** As shown in Table 6, intra-ASEAN trade share grew from 17.0% in 1990 (pre-AFTA) to 25.0% in 2011, representing a significant improvement. However, this trade share is still significantly lower than that of NAFTA and the EU. Also, the improved intra-ASEAN trade needs qualification. It may not necessarily be attributable to the implementation of AFTA and ATIGA, as tariff preference utilization rates have been consistently low in a number of studies. On the other hand, it could be argued that the removal of some NTBs and improvements in customs and trade logistics as a result of AFTA and ATIGA have improved intra-ASEAN trade.

At the country level, the intra-ASEAN trade share between 1990 and 2011 has declined for Brunei Darussalam and Cambodia, remained stable for Malaysia, Lao PDR and Viet Nam, and increased for the other ASEAN countries. By 2011, dependence on intra-ASEAN trade is highest for Lao PDR and lowest for Viet Nam. Lao PDR is a landlocked country and heavily dependent on trade with neighboring Thailand, while Viet Nam's dependence on trade with ASEAN has declined since normalization of trade with the US and accession to the WTO. Cambodia's dependence on ASEAN trade declined with increased exports of garments to the US and EU markets.

**Table 6: Intra-ASEAN Trade as % of Country Total Trade, 1990–2011**

	1990	1995	2000	2005	2010	2011
Brunei Darussalam	27.5	35.3	33.9	34.1	24.7	19.6
Indonesia	9.3	14.6	18.2	22.9	24.6	26.1
Malaysia	24.3	22.4	25.4	25.5	30.4	26.0
Philippines	9.3	11.7	15.6	18.1	23.9	21.2
Singapore	19.5	26.2	26.1	31.3	27.3	26.5
Thailand	12.6	15.6	18.1	20.0	19.8	24.3
Cambodia	56.6	73.6	24.8	15.8	45.9	23.4
Lao PDR	63.2	55.7	65.1	65.2	62.2	64.0
Myanmar	26.9	39.1	35.6	51.2	43.2	48.3
Viet Nam	16.6	25.0	23.5	21.2	18.0	17.2
ASEAN10	17.0	21.1	22.8	25.5	25.6	25.0

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.

Source: Compiled from ASEAN Secretariat trade statistics (ASEAN, 2013).

As shown in Table 7, countries show asymmetric dependence on trade with ASEAN. Brunei Darussalam, Cambodia, Indonesia, and Lao PDR are much more dependent on ASEAN sourcing than ASEAN as a market, while the reverse is true of Singapore and Thailand. The bulk of intra-ASEAN trade (87.7% in 2011) is accounted for by

Indonesia, Malaysia, Singapore, and Thailand, with Singapore alone accounting for 34.4%.

**Table 7: Intra-ASEAN Trade by Country, 2011**

	Intra-ASEAN imports % of country			Intra-ASEAN exports % of country			Total Intra-ASEAN trade % of country		
	\$ million	% distrib.	Imports	\$ million	% distrib.	exports	\$ million	% distrib.	trade
Brunei Darussalam	1191	0.4	48.4	1721	0.5	13.9	2912	0.5	19.6
Indonesia	57254	21.1	32.3	42099	12.9	20.7	99353	16.6	26.1
Malaysia	52090	19.2	27.8	56050	17.1	24.6	108140	18.1	26.0
Philippines	15040	5.6	23.6	8635	2.6	18.0	23676	4.0	21.2
Singapore	78126	28.9	21.4	127545	38.9	31.2	205671	34.4	26.5
Thailand	39224	14.5	17.0	72227	22.1	31.6	111450	18.6	24.3
Cambodia	2170	0.8	35.4	834	0.3	12.4	3004	0.5	23.4
Lao PDR	1571	0.6	71.1	960	0.3	55.0	2530	0.4	64.0
Myanmar	3250	1.2	47.8	3957	1.2	48.7	7208	1.2	48.3
Viet Nam	20793	7.7	20.0	13505	4.1	14.2	34298	5.7	17.2
ASEAN10	270710	100.0	23.6	327532	100.0	26.4	598242	100.0	25.0

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.  
Source: Compiled from ASEAN Secretariat trade statistics (ASEAN, 2013).

Since the inception of AFTA in 1993 intra-ASEAN trade had grown from \$82 billion to reach \$598 billion by 2011. At the outset, the intra-ASEAN trade centered on Singapore, largely the Singapore–Malaysia bilateral trade, and to a lesser extent the Singapore–Indonesia and Singapore–Thailand bilateral trade. The Singapore entrepôt was importing for re-export the primary commodities of neighboring countries and exporting to them the manufactures from industrialized countries and increasing intra-ASEAN trade in parts and components. However, with the growing importance of oil and gas production and as ASEAN countries industrialize and participate in production networks, trade among ASEAN countries other than Singapore grew, and the intra-ASEAN trade increasingly comprises trade in petroleum and petroleum products and manufactures, particularly parts and components of the electrical and machinery industries (Table 8).

**Table 8: Intra-ASEAN Trade at HS 2-digit, 2011**

HS 2-digit	Intra-ASEAN			Intra-ASEAN		
	Exports	Imports	Total	Exports	Imports	Total
	\$ million			% distribution		
01–05 Animal & animal products	2808.7	2462.9	5271.6	0.9	0.9	0.9
06–15 Vegetable products	15290.5	12206.8	27497.3	4.7	4.5	4.6
16–24 Foodstuffs	13186.0	8664.7	21850.7	4.0	3.2	3.7
25–27 Mineral products	83597.8	81215.1	164812.9	25.5	30.0	27.5
28–38 Chemical and chemical products	19695.2	15250.8	34946	6.0	5.6	5.8
39–40 Plastics & rubbers	24494.6	15163.6	39658.2	7.5	5.6	6.6
41–43 Raw hides, skins, leather, furs	633.8	505.0	1138.8	0.2	0.2	0.2
44–49 Wood and wood products	5799.2	6068.4	11867.6	1.8	2.2	2.0
50–60 Textiles	3523.0	2711.3	6234.3	1.1	1.0	1.0
61–63 Apparel	1316.0	1145.6	2461.6	0.4	0.4	0.4
64–67 Footwear and headgear	599.1	462.5	1061.6	0.2	0.2	0.2
68–71 Stone and glass	5655.0	6223.0	11878	1.7	2.3	2.0
72–83 Metals	20580.4	17557.1	38137.5	6.3	6.5	6.4
84 Machinery	42606.5	27099.6	69706.1	13.0	10.0	11.7
85 Electrical machinery	58800.9	53058.5	111859.4	18.0	19.6	18.7
86–89 Transportation	17879.0	14010.6	31889.6	5.5	5.2	5.3
90–92 Precision instruments	6689.1	4364.6	11053.7	2.0	1.6	1.8
93–97 Miscellaneous	2012.3	1546.2	3558.5	0.6	0.6	0.6
98–99 Others	2364.9	994.7	3359.6	0.7	0.4	0.6
TOTAL	327531.8	270710.4	598242.2	100.0	100.0	100.0

ASEAN = Association of Southeast Asian Nations; HS = harmonized system.

Source: Compiled from ASEAN Secretariat trade statistics (ASEAN, 2013).

**Utilization of CEPT tariff preferences.** A number of studies showed that the CEPT had a low utilization rate (for example, The 1999, Dennis and Yusof, 2003, Kawai and Wignaraja 2011). Reasons include the following. First, the low margin of preference (MOP) between MFN and CEPT rates, with zero MOP for Singapore, and for some products in other ASEAN countries. For the latter, most electronic products and components enjoy zero MFN tariffs under the WTO's Information Technology Agreement as well as under duty-drawback schemes in ASEAN export processing zones. Second, problems with customs valuation and rules of origin. Apart from problems with customs authorities,<sup>24</sup> some exporters find it difficult to qualify under the value added ROO because of the prevalence of outward processing in production networks.<sup>25</sup> Third is the high cost of logistics, transportation, and telecommunications.<sup>26</sup> Fourth, many SMEs were unfamiliar with applying for tariff preferences under the CEPT.

<sup>24</sup> These include lack of consistency in treatment by customs authorities of the Form D Certificate of Origin, uncertainty on the authorized issuer of the forms, lengthy time for the forms to be issued, uncertainty on the status of tariffs, and complicated payments arrangements.

<sup>25</sup> The initial CEPT Agreement contains only one sentence pertaining to rules of origin: "A product shall be deemed to be originating from ASEAN Member States, if at least 40 per cent of its content originates from any Member State". This simple statement gave rise to different customs interpretations and disputes.

<sup>26</sup> The World Bank's Ease of Doing Business Index shows wide variations in these costs in ASEAN countries.

**FDI Inflows and Intra-ASEAN FDI.** The main basis of ASEAN economic integration is not regional market pooling and increasing the intra-ASEAN trade share, but rather that of increasing competitiveness in the global market. In this, attracting FDI and integrating into production networks plays a crucial role. It is difficult to determine the impact of AFTA, AFAS, and AIA on FDI inflows.<sup>27</sup>

ASEAN's share of global FDI destined for the developing world has been declining in recent decades for two major reasons: the rise of the PRC and its growing attraction for foreign investors, and the negative effect of the 1997–1998 Asian financial crisis. FDI inflows to several ASEAN countries dropped sharply in the aftermath of the crisis. However, without the attractions of ASEAN economic integration, FDI inflows could have fared worse.

Unlike the EU and NAFTA, intra-regional investments have been limited in ASEAN as all member countries are net recipients of FDI. Intra-ASEAN investments are dominated by investments among Singapore, Malaysia, and Thailand. In recent years CLMV as well as Indonesia have attracted sizeable investments from the more developed ASEAN countries, with regional economic integration playing a significant role in improving the investment climate in CLMV. Table 9 shows that the bulk of intra-ASEAN investments from 1995–2006 was received by Thailand, Singapore, and Malaysia and to a lesser extent by Indonesia and Viet Nam. More recent evidence shows that Singapore is a major investor in Indonesia, Malaysia, Cambodia, Myanmar and Viet Nam.

**Table 9: Intra-ASEAN FDI Flows by ASEAN Host Country**

Host country	1995	2002	2003	2004	2005	2006	1995– 2006	1995–2006
	\$ million							% distribution
Brunei								
Darussalam	311	21	37	25	19	10	1434	3.6
Indonesia	609	1337	384	32	883	1524	4295	10.7
Malaysia	1677	0	251	980	573	468	9030	22.4
Philippines	242	38	175	116	13	-96	1272	3.2
Singapore	1165	774	637	649	1176	1138	9459	23.5
Thailand	161	1223	670	336	762	2822	9760	24.2
Cambodia	0	9	20	32	129	156	383	0.9
Lao PDR	7	8	3	8	7	11	287	0.7
Myanmar	97	25	24	12	38	28	1113	2.8
Viet Nam	387	200	100	243	165	182	3286	8.2
ASEAN10	4654	3634	2302	2433	3765	6242	40316	100.0

ASEAN = Association of Southeast Asian Nations; FDI = foreign direct investment; Lao PDR = Lao People's Democratic Republic.  
Source: Chia (2011).

**Implementation Issues of AFTA, AFAS, and AIA.** The *Mid-Term Review of the Hanoi Plan of Action* highlighted the following implementation problems. First, weak commitments to some of the decisions to promote liberalization and cooperation programs, possibly due to poor awareness of the benefits of liberalization with inadequate or late submission of necessary information. Weak commitment was also reflected in the low level of representation at negotiations and meetings, resulting in

<sup>27</sup> The AIA includes the goal of joint investment promotion by ASEAN countries in missions to Japan, Europe and the US, but these have not been an unqualified success as officials were more interested in promoting national interests.

inability to make critical decisions at such meetings. Second, slowness in implementing decisions reflects the need to consider and consult diverse national, sectional, and private sector interests that could be time consuming, particularly where there are perceived conflicts between ASEAN commitments and the various interests. Third, new national legislation and changes to existing national legislation to accommodate the ASEAN commitments are often time consuming. Fourth, at times, delays in implementation are also due to lack of appropriate and sufficient technical capacity for implementation and/or inadequate financial resources (ASEAN 2001).

Severino (2006), a former ASEAN Secretary-General, candidly assessed the reasons where ASEAN had fallen short on implementation. First, a fundamental problem is that most ASEAN governments do not feel a sufficient identification of the national interest with regional economic integration and most ASEAN firms do not see how their businesses benefit from such integration. Most national governments and firms place more value on extra-ASEAN markets, and national governments feel no pressure from their business sectors to move faster on regional economic integration. Second, NTBs are largely opaque and hard to identify and even more difficult to remove. Streamlining customs operations and coordinating them regionally may require the overhaul of entire cultures at some national customs' authorities. Regulatory bodies may have to give up a measure of their authority in order to harmonize product standards with other ASEAN countries and give recognition to those countries' certificates of compliance with regulations. Governments will have to ensure that firms adjust to ASEAN norms and abandon the standards that they have adhered to for years. Third, services are even more sensitive than trade in goods. Liberalizing transportation services would expose to greater competition national airlines, shipping lines, and land transport companies, many of which are state-owned or crony-owned and used to state protection. Trans-boundary transport arrangements can also be held hostage to political disputes or pressures. Fourth, ASEAN has no compliance or enforcement mechanisms and failure to implement carries no sanctions. The ASEAN Secretariat has no power to enforce agreements or the authority to make transparent the cases of non-compliance.

### **3.5 AEC Scorecard for 2008–2011**

The AEC Blueprint provides a roadmap with a timeline for implementing the necessary economic measures and actions and the ASEAN Scorecard was developed to track implementation. The implementation rate for 2008–2011 was 67.5%. Table 10 shows the scorecard reporting measures that were fully implemented or not fully implemented for the AEC's four pillars and components. Highlights are as follows:

- Implementation rates are highest for the fourth pillar (integration into the global economy), but less than 70% for the other three pillars. Implementation rates are also higher for Phase I (2008–2009) than for Phase II (2010–2011). Thus, instead of accelerating implementation as the target date of 2015 draws nearer, ASEAN countries seem to be slackening. Alternatively it could mean that as “the low hanging fruits are first plucked, the fruits further up the tree are more difficult to reach.”
- For the single market and production base, implementation in services is the most problematic, followed by investment. The main problem with investments is enforceability, as the TEL and SL lists allow ASEAN countries to delay or opt out of implementing measures. Many of the outstanding measures are in trade facilitation. For the competitive economic region, measures not fully implemented are primarily in transport, with delays in ratification of regional agreements and translating them into respective national laws. For equitable economic development, non-full implementation is mainly in SME development.

- At the national level, all ASEAN countries have fully implemented freer flow of capital (except Myanmar), free flow of skilled labor, priority integration sectors, competition policy, mineral, ICT, taxation (except Cambodia), and e-commerce. They have also more than half implemented the free flow of goods, services and investments, food-agriculture-forestry, consumer protection, transport, energy, IAI, and external economic relations. In IPR, the compliance record is mixed, with full implementation by Malaysia, Philippines, Singapore, Thailand and Viet Nam. The record is also mixed in SME development with full implementation by Indonesia, Malaysia, Singapore, and Thailand.

**Table 10: AEC Scorecard**

Key Areas	Phase I (2008–2009)		Phase II (2010–2011)		Total Measures	
	Fully Implemented	Not fully Implemented	Fully Implemented	Not fully implemented	Fully Implemented	Not fully implemented
<b>Single market and production base</b>						
Free flow of goods	9	0	23	24	32	24
Free flow of services	10	3	13	17	23	20
Free flow of investment	5	1	5	8	10	9
Freer flow of capital	1	0	5	0	6	0
Free flow of skilled labor	.	.	1	0	1	0
Priority integration sectors	28	0	1	0	29	0
Food, agriculture, and forestry	8	0	5	6	13	6
Total number of measures	61	4	53	55	114	59
Implementation rate	93.8%		49.1%		65.9%	
<b>Competitive economic region</b>						
Competition policy	2	0	2	0	4	0
Consumer protection	2	0	5	4	7	4
Intellectual property rights	.	.	4	1	4	1
Transport	15	10	6	8	21	18
Energy	0	0	2	1	2	1
Mineral	1	0	7	0	8	0
ICT	2	0	4	0	6	0
Taxation	.	.	0	1	0	1
e-commerce	.	.	1	0	1	0
Total number of measures	22	10	31	15	53	25
Implementation rate	68.7%		67.4%		67.9%	
<b>Equitable economic development</b>						
SME development	1	0	4	3	5	3
IAI	2	0	1	1	3	1
Total number of measures	3	0	5	4	8	4
Implementation rate	100%		55.5%		66.7%	
<b>Integration into global economy</b>						
External economic relations	5	0	7	2	12	2
Total number of measures	5	0	7	2	12	2
Implementation rate	100%		78%		85.7%	

AEC = ASEAN Economic Community; IAI = Initiative for ASEAN Integration; ICT = information and communication technology; SME = small or medium-sized enterprise;  
Source: ASEAN (2012).

- The aggregate scores fail to reveal the rates of implementation for individual countries and for different parts of a country (for example, the capital city versus other provinces and areas) and on each of the policy actions in the Blueprint. By not making public the compliance record of individual countries, there is no “public” pressure for compliance. The lack of sanctions for non-compliance reflects the club-



like nature of ASEAN and the downplay of legalism among club members. On the other hand, if a more legalistic stance with sanctions for non-compliance had been adopted, then ASEAN leaders would be more reluctant to commit to so many liberalization and facilitation measures.

## 4. THE AEC BY 2015 AND BEYOND

Realizing the AEC by 2015 could be interpreted in two ways. First, it would mean full implementation of all the actions and measures listed in the AEC Blueprint. Second, it would mean realizing the AEC objectives of a single market and production base, a competitive economic region, equitable economic development, and integration into the global economy. The scorecard only monitors compliance in implementing the specific actions and measures indicated in the AEC Blueprint. It gives no indication of how far the AEC objectives are being realized.

### 4.1 Implementing the AEC Blueprint by 2015

The immediate priority is to improve the implementation of AEC Blueprint's strategic actions so that the 2015 timelines can be met as far as possible. Problematic areas are measures pertaining to services liberalization, trade facilitation, and free flow of skilled labor.<sup>28</sup> It is crucial that efforts are intensified both at regional and country levels to close the implementation gaps. As discussed earlier, obstacles to implementation include legislative and regulatory limitations and effective coordination of implementation across various national ministries and agencies. A better effort needs to be made to gain the acceptance of legislators, government officials, business leaders, and the general public of the benefits of trade and investment liberalization and of the costs of non-action. In any FTA, there are winners and losers. Winners are businesses, investors, workers, and consumers that gain directly from liberalization and integration, while losers are those businesses and workers that face intensified competition from foreign suppliers, investors, and professionals. There should be greater understanding of the political economy of FTAs. Policymakers have the tough task of marketing the liberalization idea, commissioning and disseminating studies on the benefits of economic integration, seeking consultations with the private sector and workers to identify short-term losers, and finding mechanisms to "compensate" losers through financial, technical assistance to enable firms to seek new businesses and workers to undertake training for new jobs. Some ASEAN countries such as Singapore have been more successful than others in achieving this objective.

Monitoring the progress of the AEC should be strengthened. There is a need to strengthen the monitoring capacity of the ASEAN Secretariat and provide technical assistance to member states to enhance their implementation capacity. Greater private sector feedback should be undertaken to assess the impact and effectiveness of the policies and measures being implemented, so as to address the business impediments to the free flow of goods, services, investments, capital, and skilled labor.

There is growing consensus that it would not be possible to fully implement the AEC Blueprint by end-2015, particularly as some measures such as the removal of NTBs and investment in infrastructure have long gestation periods. The important thing is to set in motion the process, even if full implementation extends beyond 2015.

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<sup>28</sup> The AEC Blueprint Table 8 lists the outstanding measures not implemented in the 2008–2011 period.

The *Mid-Term Review of the Implementation of The AEC Blueprint* (ERIA 2012) notes that the drive toward AEC 2015 is already contributing to a surge in FDI to the ASEAN region, in part due to substantive achievements in AEC measures. Reduction and elimination of tariffs has resulted in a rise in ASEAN import sourcing of individual countries and a geographic diffusion beyond the earlier Singapore–Malaysia trade concentration. On trade facilitation, the private sector in ASEAN has noted favorably the improvements in customs and import and/or export clearance in many ASEAN countries in recent years. On investment liberalization, commitments in the goods sector under ACIA are remarkably liberal in most ASEAN countries, using as a yardstick a minimum of 70% allowable foreign equity. However, there remains room for further liberalization through a reduction in the number of industries in the ACIA Reservations List.

## 4.2 Realizing the AEC Objectives

Promoting trade and investment liberalization and facilitation in the AEC has a caveat: it should be accompanied by efforts to improve governance and the rule of law and to improve the capabilities and capacities of local businesses and local workers to compete regionally and internationally. The action plans outlined in the AEC Blueprint for 2008–2015 are inadequate to realize the objectives of the AEC. More needs to be done.

### 4.2.1 AEC with equitable economic development

**Goods sector liberalization.** Tariff elimination has largely been on schedule and even brought forward. However, utilization rates of FTA tariff preferences are low. Some of the problem areas such as ROO and certification and customs procedures are being addressed. Further efforts are needed in simplifying customs procedures and improving certainty of customs outcomes (including removing corruption). A customs union would remove the problems associated with ROO, but it has problems of its own as discussed later. To improve tariff preference utilization rates, more publicity, enhanced website information, and training programs targeted at SMEs are called for. The removal of NTBs has been slow, including those that impede supply chains such as the administrative-regulatory regime and inefficient trade logistics. Some of these barriers are indicated in the components of the World Bank Ease of Doing Business Index (World Bank, 2013) and the Logistics Performance Index (World Bank, 2012) and further action is called for.

**Services sector liberalization.** The services sector will play an increasing role in ASEAN economies to support the growth of services in consumption and services inputs in production, as well as the development of service sectors such as telecommunications, transportation and logistics, education and healthcare. The ERIA *Mid-Term Review* found that the benefits of services liberalization exceed those from tariff elimination. So far, services liberalization commitments from ASEAN countries range from moderate to high. Liberalization under Mode3 (right of establishment) and Mode4 (movement of natural persons) are low. ASEAN needs to redouble efforts to ensure AFAS targets are met and the various flexibilities and carve outs minimized.

**Investment liberalization, facilitation, and protection.** Countries need to re-examine their exclusion lists and avoid changes in direction in investment policies that create uncertainties for investors. Also, foreign investors often have difficulties accessing various factors of production such as land, finance, and skilled workers. Creating special economic zones would help create an investment-friendly environment for FDI. One such example is the highly successful Iskandar region in southern Malaysia that is attracting

investments from neighboring Singapore where businesses face rising land and wage costs and severe labor shortages. At the same time, ASEAN countries need to redouble efforts to develop local SMEs so that they can compete with the foreign investors and suppliers and enter into joint ventures to exploit new business opportunities.

**Mobility of ASEAN skilled professionals.** Some of the domestic regulatory constraints on employment of foreigners should be re-examined, including constitutional constraints. ASEAN professional bodies should meet regularly to get better acquainted and explore common visions and exchanges. Professional education and training at the national level should be strengthened, including English language proficiency, so that while inviting inflows of foreign professionals, local professionals will also likewise to access other ASEAN markets.

#### 4.2.2 Competitive economic region

This entails reduction and/or elimination of various behind-the-border measures that impede free flow of goods, services, investment, capital, and skilled labor and national treatment of foreign suppliers, investors, and professionals. The effective implementation of competition policy would help ensure a level playing field for domestic (private and state-owned enterprises) and foreign investors. So far the AEC has no provisions for opening up government procurement, due to sensitivities in a number of ASEAN countries. However, opening up government procurement is now standard in most FTAs, including the Trans-Pacific Partnership (TPP) agreement that some ASEAN countries are now negotiating—a compromise would be to agree on certain thresholds that would be open to foreign bidders. The AEC may also need to adopt regional environmental standards in the light of the impact of climate change and introducing basic labor standards to protect the lowly skilled. Corruption is anti-competitive behavior and the weakness in a number of ASEAN countries and needs to be controlled on efficiency and equity, if not moral, grounds.

#### 4.2.3 Equitable economic development

The AEC Blueprint strategic actions for SME development and Initiatives for ASEAN Integration are inadequate to narrow the development gap within and between countries. Promoting the accelerated and equitable development of CLMV is the surest way to narrow the development gap between them and the ASEAN6.<sup>29</sup> ASEAN could explore how the ASEAN6 can render more assistance to CLM (that is excluding Viet Nam that has reached the status of a low middle-income country) to reach middle income status. Assistance could include studying their best practices, encouraging investment flows from their private sectors, and providing more technical assistance in public sector management, human resource development, urban and transport development and agricultural development. CLMV would be major beneficiaries of the ASEAN Connectivity Plan and ASEAN Infrastructure Fund—actions and measures under the Asian Development Bank's Greater Mekong Subregion (GMS).

There has been discussion in some circles, of ASEAN adopting the structural and cohesion funds of the EU (for example, ADBI 2012). However, issues on the sources of such funding and the likely beneficiaries have to be resolved. Unlike the EU where the biggest economies are also the richest, in ASEAN the highest per capita incomes are the small economies of Singapore and Brunei Darussalam. A stronger case can be made for such a fund if there is consensus on the funding formula, such as based on deviation from

<sup>29</sup> Current political and economic reforms underway in Myanmar are attracting large inflows of FDI and will herald a new era of high economic growth.

the weighted mean per capita income of all 10 ASEAN countries, or if funding is purely on a voluntary basis.

#### 4.2.4 Full integration into the global economy

This AEC scorecard had a perfect score for implementation of this fourth pillar. ASEAN has a market of 600 million people, exceeding NAFTA and the EU in population size but only a fraction of their economic size. Hence the need for ASEAN to practice open regionalism and widen its economic networking through various ASEAN-wide FTAs, integrate further into global production networks and supply chains, and play a more active role in the WTO.

In November 2012, ASEAN initiated the Regional Comprehensive Economic Partnership (RCEP) with the six FTA partners of the PRC, Japan, Republic of Korea, India, Australia and New Zealand. Negotiations began in early in 2013 and are expected to be concluded by 2015. The RCEP is an attempt to reinforce ASEAN centrality, as there is some concern that ASEAN centrality would be undermined as the economic gravity shifts to PRC–Japan–India. With only some ASEAN members being part of the TPP negotiations, the RCEP will serve to unite ASEAN under the Asian-FTA track. With ASEAN united under the AEC, it should be able to pursue its goals on the international and regional stage much more forcefully and effectively.

## 5. CONCLUSION — Moving Beyond 2015

In summary, the AEC has come a long way, but it has fallen short of the high standard and time frame it has set for itself. With the completion of the AEC at end-2015, ASEAN would have achieved a level of deep economic integration not commonly found in the developing world. Much remains to be addressed, and some of these are discussed below.

**An ASEAN Customs Union?** A customs union (CU) with a common commercial policy would ensure a single market as goods would not be subject to certification of rules of origin and non-tariff barriers. There are good reasons why there are very few CUs in the global economy, as compared to the proliferation of FTAs. First, countries have to pool sovereignty over their commercial policies, thus reducing the national policy space. Second, it is difficult to reach agreement on a common external tariff (CET) for ASEAN in view of the wide dispersion of tariff rates across ASEAN countries, with Singapore–Brunei Darussalam having essentially zero MFN applied tariffs and CLMV having relatively higher tariffs. With its role as an entrepôt and its heavy dependence on imports for consumption and inputs into production, a positive CET would undermine Singapore's cost competitiveness and cost of living, as well as subjecting it to WTO sanctions. A customs union would become more feasible if overall ASEAN's MFN applied tariffs are reduced to zero or near zero. However, as commercial policy covers not only tariffs but also the removal and harmonization of NTBs (including natural resource subsidies, and preferential treatment of state-owned enterprises), many ASEAN countries would find it difficult to surrender national sovereignty for a CU. Businesses surveyed are not so much concerned with tariffs inhibiting trade and investment, as with obstacles posed by various NTBs and institutional practices.

**Free movement of labor and capital?** ASEAN might consider completing the common market by including other aspects that have hitherto been excluded from the AEC Blueprint. For example, the Blueprint only envisions the free movement of skilled labor and the freer movement of capital. Implementing free movement of unskilled labor across

ASEAN will be at least as politically difficult as the creation of a CU, as countries with very large populations, high numbers of unemployed, and low skilled workforces are also the low income and low wage countries, while high-income Singapore and Brunei Darussalam have limited land and populations and would face severe spatial and social constraints. What is more politically acceptable would be effective regional cooperation in managing the large legal and illegal intra-regional flows of low-skilled workers. Such cooperation could include sharing information on the demand for and supply of such workers, policing common borders to prevent illegal flows and human trafficking, greater transparency on the terms of employment for low-skilled workers, and better protection of the rights of such workers from abuse by recruiting agencies in home countries and placement agencies and unscrupulous employers in host countries.

With greater volatility in global financial markets in recent years, ASEAN governments are understandably reluctant to commit to free flow of capital, with the threat to domestic financial volatility. Further, proposals for financial integration have taken a back-seat since the outbreak of the eurozone crisis. What are progressing are the ASEAN+3 cooperative arrangements of regional financial surveillance (AMRO), the multilateralized Chiang Mai Initiative (CMIM), and the Asian Bond Market Initiative (ABMI).

**Strengthening the ASEAN Secretariat?** There have been calls to enlarge and strengthen the ASEAN Secretariat to meet the growing needs of ASEAN as an economic, political–security, and socio–cultural community. There are two issues being debated: one is the work scope and responsibility of the secretariat, and the other is the funding for an enlarged secretariat.<sup>30</sup> On the economic front, the ASEAN Secretariat has to effectively perform, among other things, the functions of coordinating and monitoring ASEAN economic integration as well as integration with ASEAN+1 FTA partners. The issue of delegation of authority to a supranational authority meets with resistance from several ASEAN governments. At the same time, an enlarged secretariat needs more funding resources. The existing formula of equal payment by all 10 ASEAN countries is unsustainable and an alternative formula has to be found, with some ASEAN countries paying more than others. The funding formula adopted by the CMIM could be looked at. Additionally, the ERIA *Mid-Term Review* recommended strengthening the secretariat's monitoring function through outsourcing: first, introduce third party technical resource and monitoring by the secretariat with support from regional research institutions (including ERIA); and second, establish a supplementary monitoring system at regional and national levels and use academic and business insights to supplement the AEC Scorecard.

**ASEAN and the WTO.** Some ASEAN members are of the view that regionalism (whether AEC, RCEP, or TPP) should be seen as stepping stones to the bigger goal of trade and investment liberalization through the WTO. As Singapore's Trade and Industry Minister, Lim Hng Kiang observed: "Even with progress made on RCEP and TPP, they should not be seen as ends in and of themselves. Rather success on these fronts should be seen as building momentum towards a longer-term goal of reforming the multilateral trading system. Ongoing WTO talks in Doha Round should not be abandoned or allowed to falter. The WTO remains the best insurance against protectionism and predictability for traders and businesses from all countries, small and large, developed and developing" (Lim 2013).

Additionally, the WTO has successfully launched its "aid for trade" initiative. ASEAN could apply for technical assistance to implement its capacity building programs, such as the development of its SMEs.

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<sup>30</sup> Critics usually point to the huge bureaucracy and budget of the European Commission as bad lessons of supranationality.

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