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**Working Paper**

## The ASEAN Economic Community and the European experience

HWWI Research Paper, No. 2-4

**Provided in Cooperation with:**

Hamburg Institute of International Economics (HWWI)

*Suggested Citation:* Plummer, Michael G.; Click, Reid W. (2006) : The ASEAN Economic Community and the European experience, HWWI Research Paper, No. 2-4, Hamburgisches WeltWirtschaftsinstitut (HWWI), Hamburg

This Version is available at:

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# The ASEAN Economic Community and the European Experience

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**HWWI Research**

Paper 2-4  
by the  
HWWI Research Programme  
International Trade and Development

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info@hwwi.org | www.hwwi.org  
ISSN 1861-504X

Editorial Board:  
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September 2006

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# **The ASEAN Economic Community and the European Experience**

**Michael G. Plummer\*, Reid W. Click**

\*An earlier version of this paper was presented at the Inaugural Session of the Regional Integration Seminar Series, Office of Regional Economic Integration (OREI), Asian Development Bank, on November 28, 2005, in Manila, the Philippines, at the joint session of the American Economic Association/American Committee on Asian Economic Studies, January 2006, as well as at the December 2006 HWWA/HWWI conference on East Asian Monetary and Financial Integration in Hamburg, Germany. The authors would like to acknowledge interesting inputs offered at these meetings, especially those by Drs. Kawai, Rana, and Capannelli. All remaining errors are those of the authors alone.

## ***I. Introduction***

In November 2002, it was proposed at the Association of Southeast Asian Nations (ASEAN) Heads of Government meeting in Phnom Penh that the region should consider the possibility of creating an “ASEAN Economic Community” (AEC) by 2020. The name is evocative, for an “Economic Community” immediately brings to mind the European experience. In fact, when the Asian Pacific Economic Cooperation (APEC) was “re-inventing” itself, it was proposed that the words behind the organization’s acronym be replaced with “Asia-Pacific Economic Community.” This idea was rejected explicitly for fear that it would give the impression that APEC was intending to move in the direction of the EC model, which was thought to be too controversial.

That the ASEAN Heads of Government should consider an “Economic Community,” even with the baggage the term brings, is in some sense nothing new. ASEAN has always studied carefully European economic integration and seen it as a sort of “role model,” though certainly to be adapted in the Southeast Asian development context. In this paper, we will consider what lessons the European experience might hold for ASEAN, as well as extend some suggestions—based in part on the EU experience—as to how ASEAN might evolve into an AEC. We begin with a brief contextual consideration of ASEAN intra-regional economic interaction, in particular with respect to trade, with some comparison to the early years of the EU. This is followed in Section III by a review of the evolution of ASEAN economic integration, culminating in the AEC. Section IV then proceeds to delineate some salient lessons of the EU experience for ASEAN. Finally, we give some suggestions as to how the AEC might proceed in Section V.

## ***II. Intra-regional ASEAN Context***

As of 2004, intra-regional trade in ASEAN came to somewhat less than one fourth of total trade (Table 1). At the individual country level, intra-regional trade as a percentage of total trade was highest for Myanmar (almost one half) and Laos (one third). In terms of the value of intra-regional trade, Singapore is number one (followed by Malaysia), though it should be noted that Singapore’s share is particularly high due to the fact that it engages considerably in intra-regional *entrepot* trade. The ASEAN trade share was lowest for Cambodia (8 percent) and the Vietnam (13 percent). Outside of the region, approximately 14 percent of ASEAN exports was destined for the EU market, less than the 16 percent accounted for by the United States but greater than the 12 percent going to Japan. The EU is the most important *single* market for four ASEAN countries (Singapore, Laos, Myanmar, and Vietnam), the United States was the largest market for three countries (Malaysia, Thailand, and Cambodia), and Japan was the largest market for another three countries (Indonesia, the Philippines, and Brunei). The “Triad” (the United States, Japan, and the EU) also dominate foreign direct investment (FDI) flows to the region.

Hence, regional economic integration in ASEAN has to be appreciated in the context of a regional organization whose most important economic partners lie *outside* the region. As will be discussed below, this important fact has been a key reason why ASEAN economic integration has been mainly geared toward “open regionalism”; the cost of an inward-looking approach to regionalism, or “Fortress ASEAN,” would be far too high. Regionalism in developing countries that have focused on creating fortresses has generally failed (e.g., the Latin American Free Trade Area). It would be a disaster in ASEAN’s case.

Economic integration in Europe, therefore, stands in contrast to the ASEAN integration process. As we argue below, the EU<sup>1</sup> in its earlier stages of economic integration had fairly high levels of trade protection. This was reinforced in the 1950s by the European Payments Union, which discriminated in favor of intra-EU imports. These policies implied considerable costs in terms of lost welfare, and certain institutional arrangements that emerged from the EU integration process (e.g., the Common Agricultural Policy, or CAP) continue to be expensive to the EU. However, in its early stages the share of intra-regional EU trade and investment in economic interaction was far higher than is the case within ASEAN today. For example, in 1958, the first year of the implementation of the European customs union, intra-EU trade was about two-fifths of total trade.<sup>2</sup> By the time the customs union was complete, it came to over 50 percent.<sup>3</sup> Today, it stands at about 60 percent.

In addition, it is relevant to note that intra-ASEAN trade has been essentially market-driven, rather than being the result of policy-driven discrimination in favor of intra-regional economic interaction. Again, this distinguishes ASEAN from the EU. Nevertheless, while one could argue that the change from 37 percent to 50 percent in the case of the EU was in part a result of discrimination, it is important to consider the relevant historical context: in the 1950s and early 1960s, Europe was still emerging from the devastation of World War II. Although it would be difficult to assess the economic reconstruction effect (complications in devising an “anti-monde” are many), no doubt the growth over this period was the result of a “normalization process,” during which time Europe grew rapidly relative to the rest of the world. Certainly, given the size, wealth, and distance of European economies, a gravity model would predict high levels of intra-regional trade even in the absence of EU discrimination. This is not the case for ASEAN. Even if ASEAN trades much more than one would predict given the “gravity variables” noted above (see, for example, Asian Development Bank 2002 and Frankel 1997), the economic characteristics of ASEAN member countries would suggest that, while by some definitions it is a “natural economic bloc,” its most important trade and investment partners will continue to lie outside the region, at least in the medium (and probably also the long) run.

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<sup>1</sup> We have a difficult acronym issue in this paper: the European Union (EU) was the successor to the European Community (EC), which integrated the various economic communities in Western Europe, including the European Economic Community (EEC) and the European Coal and Steel Community (ECSC). We use EU throughout this paper for simplicity, but we are actually referring here to the EEC.

<sup>2</sup> Hiemenz, et. al. (1994), Table 2, p. 8.

<sup>3</sup> Ibid.

**Table 1: ASEAN Exports to Selected Partners: 2004**  
(% and US\$ millions)

OF / TO	World (US\$ mil)	ASEAN-6	ASEAN-10	CH	JA	APT <sup>1/</sup>	DA <sup>2/</sup>	CER	US	NAFTA	EU-15
Indonesia	71,550	17.1	18.2	6.4	22.3	55.6	37.8	2.9	12.3	13.3	12.2
Malaysia	126,510	24.0	25.1	6.7	10.1	51.3	44.8	3.6	18.8	19.9	11.8
Philippines	39,680	15.5	17.2	6.7	20.1	54.8	35.0	1.3	18.2	19.2	16.4
Singapore	179,674	22.0	24.3	8.6	6.4	53.2	50.7	4.2	13.0	13.7	13.7
Thailand	96,245	18.1	22.0	7.4	14.0	50.4	38.5	2.9	16.1	17.7	14.3
Brunei	4,511	17.2	17.2	4.5	38.1	73.9	35.8	14.1	8.6	8.7	2.6
ASEAN-6	518,170	20.5	22.6	7.4	12.2	52.9	43.9	3.5	15.2	16.3	13.3
Cambodia	2,589	3.0	7.5	1.1	3.5	12.5	9.1	0.1	55.9	60.0	25.5
Laos	540	19.4	32.8	2.1	1.3	36.5	35.3	0.1	0.6	1.9	27.0
Myanmar	3,161	44.6	45.3	5.9	5.2	58.5	66.2	0.4	0.0	0.6	15.5
Viet Nam	25,850	11.4	13.0	9.0	13.6	39.5	26.4	7.2	20.1	21.5	22.5
ASEAN-10	550,310	20.2	22.2	7.4	12.2	52.1	43.0	3.6	15.5	16.6	13.8

Source: IMF, *Direction of Trade Statistics, CD-Rom (April 2006)*.

<sup>1/</sup> ASEAN-10 plus PRC, Korea, Japan and Hong Kong, China.

<sup>2/</sup> Developing Asia refers to all Asia except for Japan.

In sum, in terms of real integration ASEAN's situation is quite different from that of the EU. Intra-regional trade and investment are considerably less in the case of ASEAN. The differences in the levels of economic development in ASEAN, whose member countries include among the poorest and the richest developing economies in the world, are far more significant than was the case in the EU in its early years, when each EU member country was a developed economy, or at least was so by the end of the 1950s. One should keep this in mind when trying to draw any lessons from the EU for ASEAN. Still, we would argue that the EU *process* has much to teach ASEAN, both in terms of positive and negative lessons. After all, no two development experiences are going to be the same. But this does not suggest that history has nothing to teach us.

### ***III. Evolution of ASEAN Economic Integration in a Regional Context***

There have been many excellent surveys of regional economic integration in Asia (e.g., Kawai 2005, Naya 2002, Asian Development Bank 2002).<sup>4</sup> ASEAN tends to stand at the core of Asian integration, at least from an institutional perspective. We provide in this section a brief contextual review of the evolution of ASEAN in a regional context.

Briefly, we would first suggest several factors influencing the regionalism trend in East Asia that stem directly from the Asian Financial Crisis, including: (1) the obvious contagion relationships, which demonstrated the presence of policy externalities across countries in ASEAN and the newly industrializing economies; (2) major disappointment with the US reaction to the Crisis, which left the feeling of "being in it alone together"; (3) disappointing progress in APEC in achieving closer trade and financial cooperation, as well as development assistance cooperation ("ECOTECH"); (4) Japan's

<sup>4</sup> This brief review of ASEAN integration borrows from Plummer (forthcoming) and Naya and Plummer (2005).

offer to create an Asian Monetary Fund during the Crisis (opposed by the IMF and the United States), which gave the impression that Japan wanted to be pro-active in the region; (5) arguably, China's decision not to devalue during this period, which may have also created a sense of solidarity; (6) the "New Miyazawa Plan," launched in October 1998, which dedicated \$30 billion to help spur recovery in East Asia (and has been deemed highly successful)<sup>5</sup>; and (7) the discrediting of policies promulgated by the IMF to solve the Crisis, which gave greater credibility to the "Asian approach."

Hence, the Crisis itself set the stage for serious and durable East Asian regionalism. There are many other internal and external forces at work that have expedited the process, such as the rise of regionalism globally and its potential negative effects on the East Asian region; the successful examples of the Single Market Program in Europe (discussed at length below) and, eventually, monetary union; general pessimism regarding what can be achieved at the WTO in light of failure to move forward at the Seattle and Cancun WTO ministerials; and the potential to tap the inherent benefits of FTAs.

Table 2 gives a chronology of arguably the most important Asian initiatives, with a focus on ASEAN and "ASEAN Plus Three" (ASEAN+3), that is, ASEAN, Japan, China, and South Korea. As many early agreements in ASEAN's history were mainly political and token in nature,<sup>6</sup> its first major initiative was the Asian Free Trade Area (AFTA) in 1992. With the exception of the Japan-Singapore FTA ("Japan-Singapore Economic Partnership Agreement", or JSEPA), which began implementation over ten years later, AFTA is the only example of cooperation in Asia that is similar in concept to NAFTA. However, in true ASEAN fashion, rather than overly commit to regional integration in sensitive areas, the specifics of AFTA were purposefully left somewhat ambiguous, with the agreement basically committing the ASEAN members to free trade in a 15-year timeframe. Also, the definition of "free trade" was somewhat loose, as it included tariffs in the range of 0-5 percent, rather than the traditional zero percent.<sup>7</sup> After the original agreement, ASEAN broadened the scope of goods covered by AFTA, and the period of implementation has been shortened such that AFTA was technically in full effect at the beginning of 2004 for the original ASEAN countries and Brunei, though there are transitional periods for products on the temporary exclusion lists (e.g., sensitive products such as rice and automobiles in some cases) and some country-specific implementation problems in certain areas. The original target for full implementation for the newer ASEAN members was 2006 for Vietnam, 2008 for Laos and Myanmar, and 2010 for Cambodia. Recently, ASEAN decided to speed up the process such that AFTA would be fully completed by 2007. ASEAN has also made important strides in the area of investment cooperation, e.g., in the form of ASEAN "one-stop investment centers" and the ASEAN Investment Area (AIA).<sup>8</sup> These efforts at industrial cooperation have been designed with essentially the same goal in mind as AFTA, namely, to reduce transaction costs associated with intra-regional economic interaction.

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<sup>5</sup> Kawai (2005).

<sup>6</sup> For example, the Preferential Trading Agreement (PTA) was a positive-list approach to trade liberalization with small margins of preference and limited product coverage, expanded somewhat during the 1980s but with no real impact on trade. Industrial cooperation, such as the ASEAN Industrial Project (AIP) system, never really got off the ground.

<sup>7</sup> In fact, this range of tariffs probably contradicts the requirements spelled out in Article XXIV of the GATT/WTO, but as was noted earlier ASEAN benefits from the Enabling Clause, which has always freed it from these constraints.

<sup>8</sup> A salient component of the AIA is the ASEAN Industrial Cooperation (AICO) Scheme, which offers more in terms of tariff (0-5 percent) and non-tariff incentives than the traditional industrial cooperation programs. Moreover, in September 1996 the ASEAN countries created the ASEAN Agreement for the Promotion and Protection of Investments, which among other things stipulates the simplification of investment procedures and approval processes, as well as enhanced transparency and predictability of FDI laws.



As was noted above, in November 2002 the ASEAN Heads of Government proposed that the region should consider the possibility of creating an “ASEAN Economic Community” by 2020.<sup>9</sup> This explicitly put the European experience front and center in terms of design, though clearly the ASEAN leaders had in mind an Economic Community with ASEAN characteristics. The ASEAN leaders actually agreed, at the Bali ASEAN Summit in October 2003, to create a region in which goods, services, capital, and skilled labor would flow freely, though the details remain to be worked out. We offer our own recommendations in this regard, colored by the EU experience, in the penultimate section.

The reasons behind the decision to create the AEC are many, including: (1) the desire to create a post-AFTA agenda that would be comprehensive; (2) the perceived need to deepen economic integration in ASEAN in light of the new international commercial environment, especially the dominance of free-trade areas (FTAs); (3) given (2), the possibility that bilateral FTAs could actually jeopardize ASEAN integration since all member-states were free to pursue their own commercial-policy agenda; and (4) the recognition since the Asian Crisis that cooperation in the real and financial sectors must be extended concomitantly, and that free flows of skilled labor will be necessary to do this.<sup>10</sup>

In addition to an ebb in progress related to the APEC “Bogor Vision” of open trade and investment, there have been several events that have shifted the ASEAN focus to its East Asian neighbors. First, even with the successful APEC Summits at Blake Island and Bogor, the East Asian Economic Grouping (EAEG) concept, proposed as an East Asian “trade bloc” by Prime Minister Mahathir in December 1990, never faded away.<sup>11</sup> On the contrary, it began to grow in substance. Strangely, the initiative came from ASEAN’s effort to expand economic cooperation with the EU, as the EU’s desire to deal with all of East Asia led ASEAN to ask China, South Korea, and Japan to participate. The first Asia-Europe Meeting (ASEM) was held in Bangkok in March 1996, and officials from ASEAN and the rest of East Asia met with EU representatives—a format which was regularized and has continued twice a year since. Even though the initial impetus for these meetings was economic cooperation with the EU, the significance for East Asian regionalism lies in the fact that these meetings brought officials from ASEAN, China, South Korea, and Japan together to discuss issues of economic cooperation. In 1997, these meetings culminated in an informal summit of the ASEAN+3 heads of state in Kuala Lumpur.

The original “Miyazawa Plan” was initiated by Japan during the Asian Crisis to create an Asian Monetary Fund to supplement the IMF. It was opposed by the IMF and the United States but eventually led to the establishment of currency swap arrangements among East Asian countries (basically bilateral swaps between Japan and individual countries) during the annual meeting of the Asian Development Bank in May 2000, the “Chiang Mai Agreement” (CMI).

The CMI is actually a milestone in the financial cooperation of the region in that it constitutes the first step in the process of financial and monetary cooperation initiatives, which have become an

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<sup>9</sup> At the 11th ASEAN Summit in Kuala Lumpur, December 2005, the ASEAN Leaders discussed the possibility of expediting the AEC process to actually complete it by 2015 (with flexibility for new member countries).

<sup>10</sup> The free flow of all labor, including unskilled labor, was deemed too politically difficult to consider in the AEC.

<sup>11</sup> When proposed, the EAEG was highly controversial, as it suggested that Mahathir wanted to create what might have been construed as a discriminatory bloc, which ran contrary to the goals of ASEAN and, of course, APEC. At the Fourth ASEAN Summit in Singapore in 1992, it was downgraded to the more innocuous (and vague) East Asian Economic Caucus (EAEC).

increasing priority of the ASEAN+3 leaders. Since the CMI, myriad proposals for cooperation have been put on the table, and a few have actually emerged as promising new features of Asian regional cooperation. For example, the ASEAN+3 Bond Market Initiative (ABMI), which was endorsed by ASEAN officials at the ASEAN+3 deputies meeting in December 2002, endeavors to create more efficient bond markets in Asia and to reduce the risks associated with raising international capital.<sup>12</sup> A complementary initiative was started by the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which launched the Asian Bond Funds I and II in June 2003 and June 2006, respectively (see Ma and Remolona 2006).

**Table 2**  
**Chronology of Asian Integration: ASEAN and ASEAN+3**

Main Points: ASEAN	ASEAN Summit	Year	ASEAN+3 Summits	Main Points: ASEAN+3
<b>ASEAN Concord</b> -Established ASEAN Secretariat -Treaty of Amity: Mutual respect for independence, sovereignty, equality, territorial integrity and identity of nations, i.e. noninference -Establishment of "Zone of Peace, freedom, and neutrality"	1 <sup>st</sup> Bali	1976		
-ASEAN Industrial Project -Preferential Trading Agreement (PTA)	2 <sup>nd</sup> Kuala Lumpur	1977		
-PTA accelerated -ASEAN Industrial Joint Venture (AIJV) accelerated and made more flexible	3 <sup>rd</sup> Manila	1987		
-ASEAN Free Trade Area (AFTA) -Common Effective Preferential Tariff (CEPT)	4 <sup>th</sup> Singapore	1992		
	5 <sup>th</sup> Bangkok	1995		
-Proposal for ASEAN Vision 2020	1 <sup>st</sup> informal Jakarta	1996		
-ASEAN 2020 presented, a broad long-term vision for ASEAN in 2020 (with ASEAN Economic Community in mind)	2 <sup>nd</sup> informal Kuala Lumpur	1997	1 <sup>st</sup> Kuala Lumpur	1 <sup>st</sup> meeting of ASEAN+3
Hanoi Plan of Action adopted to move towards Vision 2020: -AFTA advanced to 2002, 90% intra-regional trade subject to 0-5% tariff -ASEAN Investment Area (AIA): goal investment liberalization within ASEAN by 2010, outside ASEAN by 2020 -ASEAN Surveillance Process -Eminent Persons Group (EPG) proposed to come up with plan for ASEAN Vision 2020	6 <sup>th</sup> Hanoi	1998	2 <sup>nd</sup> Hanoi	-East Asian Vision Group (EAVG) proposed by Kim Dae Jung, President of Korea, to look into East Asian integration
EPG develops plan for Vision 2020: -Financial cooperation proposed over	3 <sup>rd</sup> informal Manila	1999	3 <sup>rd</sup> Manila	

<sup>12</sup> For more details on this initiative, see the ADB's "Asian Bond Markets Initiative" homepage, <http://aric.adb.org/asianbond/ASEAN-ABMI.htm>.

concern that ASEAN was not effective in responding to Asian Crisis -AFTA to be sped up -AIA to be accelerated -To respond to surge of China, need to become more competitive, attract investment, implement faster integration, and promote IT				
Adopted Initiative for ASEAN Integration (IAI): -Framework for more developed ASEAN members to assist those less developed members in need -Focus on factors needed to enhance competitiveness for new economy: education, skills development, and work training	4 <sup>th</sup> informal Singapore	2000	4 <sup>th</sup> Singapore	-East Asian Study Group (EASG) to consider EAFTA and agreement to hold East Asian Summit -Two big ideas proposed: (1) Development of institutional link between Southeast Asia and East Asia (2) Study group for merit of an East Asian Free Trade Area (EAFTA) and investment area -Financial cooperation begun, e.g., Chiang Mai Initiative (CMI) of May 2000. By March 2006, bilateral swap arrangements under the CMI came to US\$71.5 billion. -Expert group study on ASEAN-China FTA proposed
-Discussed challenges facing ASEAN: declining FDI and erosion of competitiveness. -Created a roadmap to achieve ASEAN integration by 2020 -Proposed going beyond AFTA and AIA by deepening market liberalization for both trade and investment	7 <sup>th</sup> Brunei	2001	5 <sup>th</sup> Brunei	- EAVG recommendation for EAFTA endorsed but overshadowed by China-ASEAN Free Trade Agreement proposal within 10 years, with the adoption of the Early Harvest Provision to speed up FTA -Prompted by China-ASEAN FTA proposal, Prime Minister Koizumi proposed Japan-ASEAN Economic Partnership in reaction to China-ASEAN proposal -Japan-Singapore Agreement for a New Age Partnership signed January 2002 and enforced summer 2002
-AEC end goal of Vision 2020	8 <sup>th</sup> Phnom Penh	2002	6 <sup>th</sup> Phnom Penh	EASG recommendations of deepening and broadening of East Asian integration adopted. ASEAN+3 Asian Bond Markets Initiative (ABMI) endorsed by ASEAN+3 Deputies Meeting in December 2002 in Chiang Mai.
	9 <sup>th</sup> Bali	2003	9 <sup>th</sup> Bali	At the ASEAN+3 Finance Ministers Meeting on August 7, 2003, support is extended to the ABMI as well as to other means of closer financial cooperation.
-Vientiane Action Plan -Australia attends for the first time	10 <sup>th</sup> Vientiane	2004	10 <sup>th</sup> Vientiane	China speeds up FTA with ASEAN from 2015 to 2010

Source: Adapted from Naya and Plummer (2005).

APEC's lack of influence in the Asian Financial Crisis has served to solidify East Asia's move in favor of an ASEAN+3 approach. The current spate of agreements, however, have not been extended to the entire ASEAN+3, but rather have come more from ASEAN to individual countries. For example, the completion of the China-ASEAN joint FTA study in the summer of 2001 prompted Japan to quickly initiate a study of its own with ASEAN. One month later, at the 2001 ASEAN+3 meeting in November, ASEAN and China announced their intention to negotiate a free trade area within 10 years (the agreement was formalized in a framework agreement in December 2004).

### ***III. Lessons from the EU***

In trying to glean EU lessons for the AEC, we might begin with several *caveats* regarding the differences between the subjective environments facing the EU (EEC) in the 1950s and those facing ASEAN today:

***1. The institutional environment facing ASEAN in the first decade of the 21<sup>st</sup> Century is much different than that facing the EU of the 1950s.*** European integration was clearly pushed by both memories of a devastating war and emerging Cold War concerns. The political and social motivations for economic integration were, thus, far different than those driving ASEAN initiatives today, though, it should be added, ASEAN has been instrumental in keeping Southeast Asia a peaceful region, an important contribution that is often underestimated. The "European Good" is interpreted much differently in Europe than the "ASEAN Good" in ASEAN; this puts considerable limitations on institutional development at many levels. Importantly, it reduces the possibility of the relinquishing of power by ASEAN member nations to supranational organizations. Besides, such institutional development is difficult in the ASEAN context anyway, given that: (1) nation-state formation is much younger than was the case in the European context, and in some countries this still requires a strong priority; (2) divergences in socio-political institutions are far greater than they were in the European context, especially as in some European countries these institutions were being created anew after the war; (3) it is not clear that European institution-building has been particularly successful in all areas, though it would receive high marks for economic-related matters (though this, too, is a testable hypothesis); and (4) these European institutions are quite expensive, while ASEAN government budgets are much smaller (though, fortunately, ASEAN would not have to employ an army of translators, as the EU does).

That said, it is important to note that the notion of the "ASEAN Good," though viewed differently in the ASEAN context, has been changing over the past 10 years. For instance, 10 years ago, few in the region (or the rest of the world) knew what ASEAN was; today it is well known.

***2. The international economic environment is far different today than it was in the 1950s.*** First, the contemporary global marketplace is extremely open relative to the past. This is true because of extensive reductions in trade barriers internationally, due to the GATT/WTO rounds as well as to unilateral liberalization and huge increases in international capital flows (including FDI), which have increasingly been knitting an integrated global marketplace. Hence, the costs of using regional integration as a form of "fortress," that is, to maximize trade diversion, are consequently much higher than they were in the past. Second, regionalism has grown by leaps and bounds recently; trade groupings reported to the WTO come to well over 200, with a majority being established after 1995. Some of these groupings include ASEAN's most important trading partners and could potentially

isolate ASEAN, as well as forcing it to pay the costs of trade diversion. These trends further underscore the need for the AEC to be open as well as for the organization to be engaged in the regionalism movement. The more integrated the ASEAN marketplace is, the easier this will be. These considerations were far less important in the European context.

**3. ASEAN features far greater diversity in terms of economic development.** We mentioned in Section II that ASEAN is far more diverse in terms of levels of economic development than was the case of the EU in its earliest phases, when all countries were developed. While the expansion of the EU to include 10 Central and Eastern European countries in May 2004 significantly increased diversity within the EU, the region is still dominated by developed countries and is far more symmetric than ASEAN, which features developed; “dynamic Asian economies”; middle-income developing countries; and least-developed countries. As of 2004, the coefficient of variation (standard deviation divided by the mean) on per capita income levels across ASEAN member countries came to 1.62, compared to 0.65 for the EU.<sup>13</sup> Hence, the divergence within ASEAN is far greater than that of the EU, and the countries are far poorer. This suggests that matters related to the speed of implementation of the AEC, and even the ability of ASEAN to be completely inclusive for all member-states, will be complicated and difficult. Phased “10-X” strategies, which is what AFTA in effect embraces, may be not only desirable but necessary.

**4. ASEAN countries are far more open than was the case of Europe in the 1950s.** ASEAN countries are (economically) small and very open relative to the EU of the 1950s (and even with respect to most EU countries today), with the exception of a few of the transitional CMLV (Cambodia, Myanmar, Laos, Vietnam) countries. ASEAN countries are closely integrated with international markets through international trade as well as multinational networks. Not only is this a reality, but it is also a policy focus for ASEAN governments. As noted in Section II, intra-regional trade and investment in ASEAN is far less important than was the case with the EU and will likely continue to be so in the future. This is another reason why one would expect the AEC to embrace openness much more than the EU might have. In addition, even as an integrated market, ASEAN countries together still could not influence international terms of trade (the AEC would still be relatively “small”), suggesting that the “optimal” Common External Tariff would be zero. This was not the case with the EU.

Having noted these *caveats*, we can delineate at least three major lessons that can be drawn from the real-side integration experience of the EU. First, we might begin with a *negative* lesson: ASEAN should avoid some of the pitfalls of inward-looking discrimination from which the EU continues to suffer (especially in agriculture) but which would be potentially catastrophic in the context of the ASEAN countries. Intra-ASEAN trade is only about one-fourth its global trade (compared to two-thirds in the case of the EU) and ASEAN member states are highly integrated globally. Hence, any real-side economic cooperation needs to be outward-looking. In fact, this approach is exactly what the ASEAN leaders ostensibly have in mind, that is, using ASEAN as a means of “going global.” Some scholars have noted that AFTA is actually more of an investment agreement than a trade agreement; free trade reduces intra-regional transaction costs and presents to multinational corporations a vertically-integrated market.

The AEC should never lose this vision, even when, as in the European case, compromises may have to be made. The EU countries are developed, high-income countries that together form a large

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<sup>13</sup> Authors’ calculations, using data on GDP per capita from *World Development Indicators On-Line*. In 2004, average per capita income in the 10 ASEAN countries and the 25 EU countries came to \$5,271 and \$18,984, respectively.

economic space. They were able to push economic integration behind relatively protected markets, in the context of an international economy that was still fairly closed. Today, the GATT/WTO has opened up markets considerably and most of the world, the EU and ASEAN included, have internationalized extensively. It could be argued that such a protected approach was not necessary to begin with and should have been avoided (the CAP has been, by many measures, a disaster); however, the cost of an inward-looking approach has increased exponentially. It is not a viable option for the AEC.

Second, and partly related to the first, the European experience teaches us that trade-investment links matter and that these relationships are shaping in large part the economic structure of the ASEAN economies. While the transitional ASEAN countries are still in early stages of the economic development process, the original ASEAN countries have experienced tremendous changes in their productive structures in general and trade in particular. Primary-based exports (roughly estimated as SITC 0-4) have fallen in all original ASEAN economies.<sup>14</sup> Of the original ASEAN countries only Thailand continues to have a large agricultural-export base (it is, for example, the largest exporter of rice in the world), but it, too, is falling in importance. Energy (SITC 3) continues to be important to Indonesia and Malaysia, with the former being at present a marginal oil importer. The big change throughout the region has been the impressive—in some cases, spectacular—increases in the share of SITC 7, that is, electronics and transport equipment (for ASEAN, this means mainly electronics). Over the 1990s, the share of SITC 7 increased in all ASEAN countries. Indeed, in most countries it is the largest export sector; it constituted 58 percent, 41 percent, 72 percent, and 68 percent of total exports in Malaysia, Thailand, the Philippines, and Singapore, respectively.<sup>15</sup>

While economic reform has played an important role in this process of structural adjustment, so has foreign investment. Tamamura (2002) uses input-output analysis to capture the FDI-export link in East Asia, as well as to decompose the effect of external demand (by country) on production, using electric/electronics as a case study. He finds that, for 1995 (his latest year), in every (original) ASEAN country, external demand induced more production than domestic demand except (marginally) Indonesia, where, however, domestic demand fell in relative importance from 87 percent to 52 percent. Most countries followed a similar pattern of internationalization of electronics production. The most extreme case among the ASEAN countries was Malaysia, where domestic demand induced only 6 percent production.

Next, it is noteworthy that most of the directives that led to the creation of a tightly-integrated market for FDI in Europe came with the Single European Act, which commenced in 1986-87 and essentially created what is mostly a common market by 1994. The European experience teaches us that accomplishing such a feat goes well beyond mere national treatment/most-favored-nation treatment in the regional marketplace: economic cooperation needs to reduce myriad transaction costs associated with FDI, including those related to the labor market, different product standards, and the like. The AEC will have to focus *per force* on many of these areas.

A third lesson relates to how the EU has been able to gain from intra-regional trade liberalization, though, as noted above, this could have been better organized to minimize trade

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<sup>14</sup> Data for this structural-change analysis come from Plummer (2003).

<sup>15</sup> The case of the Philippines is the most dramatic and surprising: the value of SITC 7 exports increased over this period by over 100 percent, with the largest changes in SITC 723 (civil engineering and contractors plant and parts), SITC 728 (machine & specialized equipment), 736 (machine tools), 751 (office machines), and 752 (automatic data processing machines).

diversion. The customs union played an important role in building a regional market; the Single European Act, by creating a Common External Commercial Policy, was able to do much more by keeping real-side transaction costs within the EU to a minimum and producing a truly regional marketplace, resulting in a more efficient division of labor in most markets.

It should be stressed, however, that the AEC should be concerned not merely with increasing *intra-regional* but rather with increasing *global* economic interaction more generally, of which the ASEAN market is only one part...in fact, a part that can be used as an international springboard. Trade and investment integration policies in ASEAN should be expected to achieve the same general results as they did in the EU case, but this increased interaction might actually manifest itself in a different way, given the facts that ASEAN countries are so diverse and that most are still developing countries. To reiterate: the AEC should be a means of increasing economic prosperity and the social good rather than focusing on, say, increases in (sometimes, misleading) indicators such as shares of intra-regional trade and investment. A successful integration program could theoretically lead to a decrease in regional integration, as measured by trade and investment shares, for example.<sup>16</sup>

A final point would regard the European experience with respect to financial and monetary cooperation and integration, though in part this goes beyond the traditional interpretation of the AEC (discussed below). ASEAN Member Countries have considered the formation of an ASEAN Bond Market, though problems related to liquidity, potential market depth, and the like have led ASEAN to think more in terms of an Asian Bond Market. This will be a long process.<sup>17</sup> Nevertheless, it is worthwhile to consider the European experience as well, given that empirical studies (e.g., Frankel and Rose 1998) have shown that monetary integration has strong effects on trade and investment flows.

In the past, just about every regional economic integration program focused in the beginning almost exclusively on the real side of the economy. Financial integration was always treated as something separate, to be taken up at a later date. In many ways, this is less true for European integration, though the point is debatable. While the European Payments Union (EPU) was a financial arrangement, it was only *ad hoc* and was quickly phased out as soon as European currencies became convertible. This was just as the Treaty of Rome actually began implementation. The EC did publish the Werner Report, which mapped out a plan for monetary union at a time of great turbulence in the Bretton Woods System (1968), and after the Bretton Woods System collapsed it tried to create the (short-lived) European Snake and, eventually, the European Monetary System, which expanded the Snake in March 1979. These attempts at exchange-rate cooperation were important because the “customs union plus” needed stable exchange rates in order to run well. Such cooperation was especially necessary for the CAP: the main goal of the CAP was to stabilize farmer incomes, and flexible exchange rates put this at risk, as a country with a depreciating currency had an advantage over

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<sup>16</sup> This is because, for example, a successful AEC that brings in higher FDI flows from abroad—a key aim of the AIA—would not only reduce intra-regional FDI but also could reduce intra-regional trade, if multinationals take advantage of the attractive regional division of labor offered by ASEAN. For example, suppose that, as a result of the AIA, a Japanese automobile multinational set up production stages in Indonesia and Singapore, whereby it exports \$2 billion in car components to Indonesia, adds \$100 million in labor-intensive value added to production in Indonesia, exports the semi-processed product to Singapore for further \$1 billion in processing, and then finally exports back to Japan. This means that ASEAN intra-regional trade would have changed at the margin by exports to Singapore from Indonesia (\$1.1 billion) divided by exports of Japan to Indonesia (\$1 billion) plus imports of Japan from Singapore (\$2.1 billion), or 35 percent, whereas extra-regional trade would have increased by 65 percent. The point is that this could be a successful economic activity for all parties involved, but intra-regional trade shares might fall anyway.

<sup>17</sup> See, for example, Plummer and Click (2005).

an appreciating-currency country, which was incompatible with the *acquis communautaire*. Hence, the EC had to develop a “green” exchange rate system, called “monetary compensation amounts” (MCAs), which prevented this “adverse” structural change from happening. However, this system was very expensive: Pomfret (1997) suggests that the MCAs constituted over 15 percent of the CAP’s huge budget.

Nevertheless, European capital markets tended to be substantially segmented until the implementation of the Single European Act was fairly advanced. There had been early attempts to create a single banking market as far back as 1972, 15 years after the Treaty of Rome, and in 1977 the European Council established the First Banking Directive (which did very little to integrate the markets<sup>18</sup>), but these and other attempts only marginally integrated the regional markets until the Single European Act initiatives. Today, the European banking system is far more integrated, but some aspects of finance continue to be among the few areas in which the Single Market is still incomplete. Capital controls were removed as part of the Single European Act program.

In sum, even in the case of the EU, financial integration did not keep pace with integration in the real sector. The tendency seems to be to let financial issues wait, but experience shows that this is an unwise policy. The Asian Crisis might also be seen in this light. Prior to the Crisis, APEC, for example, all but ignored financial and monetary cooperation, and ASEAN itself did little. In creating the AEC, therefore, ASEAN leaders would do well to focus on financial issues *in tandem* with real-sector integration.

Regarding EU lessons in monetary cooperation, we must again underscore that comparisons are difficult, as relative economic-divergence problems continue to be critical. Nevertheless, even the EU is a diverse group, especially if one considers regions rather than countries. Moreover, ASEAN’s needs in economic cooperation are obviously quite different than those of the EU. While ASEAN integration may be popular in the region, it is less popular than in Europe, particularly among government leaders. In addition, various EU states had perennial macroeconomic (especially, fiscal) problems; Economic and Monetary Union allowed these member-states to implement necessary austerity measures in the name of European integration. The result, after a very long process, has been convergence in terms of interest rates, inflation, and other monetary variables. Yet, the credibility of most of the original ASEAN countries in terms of monetary and fiscal policies is actually quite high, especially for developing countries: inflation tends to be quite low in the original ASEAN countries, and most countries had either budget surpluses or essentially balanced budgets prior to the Crisis. Today, most have large current-account surpluses. Nevertheless, there continue to be widely divergent interest-rate spreads within ASEAN; convergence could have a major impact on development in certain member countries (discussed below).<sup>19</sup>

Hence, neither political nor political-economy dynamics, which were favorable in the case of most eurozone countries, could be considered as important in the case of ASEAN. Nevertheless, in the aftermath of the Asian Crisis, things are changing. It has become clear to ASEAN leaders that there exist “policy externalities”; some sort of restrictions on the conduct of monetary and fiscal policy could not only improve the macroeconomic environment in the ASEAN countries but also promote regional economic stability. Moreover, the possibility of competitive exchange-rate devaluations could be

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<sup>18</sup> Story and Walter (1997) note (p.14) that of the EU’s 9,434 credit institutions at that time, 429 were classified as foreign banks, and only 107 had a parent company based in a member state. Governments were reluctant to grant licenses.

<sup>19</sup> See, for example, Plummer and Click (2005).



damaging to the implementation of the AEC. Political arguments for wanting to be part of Europe for European countries would be replaced in the ASEAN context by a fear of repeating the economic disaster of the Crisis. Such cooperation could be formally arranged inside or outside of the AEC framework, without any pretension to the initiatives leading to monetary union.

Based on the EU experience, closer financial and monetary cooperation in ASEAN could have the following benefits: (1) the necessary Maastricht-type agreements (e.g., restrictions on budget deficits, government debt, inflation, even foreign-currency exposure of the banking system), perhaps interpreted more liberally than in the EU context, that would go along with such cooperation would create a more stable macroeconomic environment in the region, thereby producing significant positive policy externalities; (2) as monetary policy would likely be driven by the most credible country/countries, less credible countries would be able to “import credibility,” much as, for example, Italy was able to import German monetary credibility; (3) interest-rate spreads would converge, making it easier to price risk at the regional level and lower the cost of capital; and (4) the harmonization of rules, accounting standards, and regulatory frameworks that might accompany regional integration as part of the AEC and in associated financial initiatives would render the region more attractive to foreign investors, as well as stimulate intra-regional capital flows.<sup>20</sup> It would also make cooperation and even institutional integration of ASEAN equity and fixed-income markets easier, something that has happened partially in the EU (e.g., smaller stock markets have integrated while the larger markets continue to function separately).

The process of financial and monetary cooperation is complicated, and effective integration demands a steady pace of progress, rather than abrupt changes, which can actually be counterproductive. The EU process of financial integration and exchange-rate cooperation, leading up to eventual monetary union, is instructive. The European Currency Unit (ECU) was a basket of the currencies of the member countries of the EC, weighted in line with each country’s GDP and foreign trade (and therefore subject to change periodically). It was introduced in 1979 as part of the European Monetary System (EMS), to be used as the benchmark for determining the overvaluation/undervaluation of individual currencies and to serve as a unit of account among the central banks participating in the EMS. No physical ECU notes or coins ever circulated, so the ECU was strictly an artificial denomination. However, certain European banks established a banking product that allowed lenders and borrowers to carry out transactions in ECU. At first, an ECU transaction was just a portfolio of transactions in the separate underlying currencies; a deposit or loan in ECU typically was recorded as separate deposits or loans in the individual currencies. However, banks soon established a clearing mechanism for the ECU, thus enabling the transfer of ECU without necessitating separate transactions in each of the component currencies. This facilitated the growth of the ECU for private commercial transactions; residents could use the ECU as a unit of account for bank deposits, and companies could use it for invoicing sales or maintaining their accounting records. The first ECU-denominated bond was issued in 1981, just two years after the introduction of the currency basket. The ECU subsequently became a significant “currency” denomination in the Eurobond markets, outranked only by the US dollar and the German mark. A substantial amount of ECU-denominated bonds were placed privately as well.

The use of the ECU in private transactions developed rapidly because the ECU exchange rate tended to be more stable than those of its component currencies. For European investors and borrowers,

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<sup>20</sup> For a more complete discussion of the potential benefits and costs of financial market cooperation and integration in ASEAN, with comparisons to Europe, see Plummer and Click (2005) and Click and Plummer (2005).

a depreciation of an individual home currency against other European currencies was offset by an increase in the home-currency value of the ECU, so there was an incentive to hold ECUs to diversify a portfolio. Similarly, non-European investors and borrowers were drawn to the ECU because it was less risky than the underlying individual currencies. In short, the ECU was an attractive alternative to single foreign currencies because it was less sensitive to the volatility of a single currency.

On January 1, 1999, the euro replaced the ECU on a one-for-one basis as part of the first stage of European Monetary Unification (EMU). The fact that the ECU existed for twenty years prior to EMU suggests that the simple introduction of a currency basket serves as a useful precursor to closer monetary cooperation. The success of the ECU was partially because its official status within the EMS bound the central banks of the participating countries together. Its success was also due in part to the fact that the private sector found a pan-European currency denomination quite useful, and because the banking system was able to accommodate the demand.

Certainly, the creation of an Asian Currency Unit (ACU) that would enjoy widespread use, or the eventual creation of a common currency in Asia, can only be a long-run goal. However, the economics are ostensibly lining up in favor of such an initiative, and certainly Asian governments have been placing a higher priority on monetary and financial cooperation. Hence, perhaps we will not be all dead when this goal is reached.

#### ***IV. On Building the ASEAN Economic Community***

Given the tremendous diversity of ASEAN, how will it be able to create its own “customs union plus”, even by 2020? Tariff dispersion rates across ASEAN countries are, indeed, impressive: while ASEAN members tend to have fairly low tariffs and non-tariff barriers relative to other developing countries (except for the transitional ASEAN economies), they still vary considerably across the region. Moreover, Singapore is unique: it essentially has no tariffs. Given the openness of its economy (trade accounts for over 300 percent of GDP), Singapore cannot raise tariff rates to accept an ASEAN Common External Tariff that is not equal to zero. The EEC did not face this problem. Likely options here would include a complete free-trade zone in ASEAN, perhaps with some external tariff harmonization, or a “10-X” customs union, in which the Common External Tariff would be determined through negotiations similar to those of the EEC, but which not all ASEAN countries would join.

It is not clear exactly what form the AEC will take. Some scholars have suggested a less ambitious approach to the AEC, including an “FTA-plus” arrangement, which would include certain elements of a common market (e.g., the free flow of capital, the free flow of skilled labor, and zero tariffs on intra-regional trade) but would not have a Common External Tariff. Noting that the European example teaches that without integrated external tariffs markets continue to be segmented and key benefits of integration are stymied, Plummer (2005) recommends that a 0-5 percent Common External Tariff in an AEC at least be explored for the more developed ASEAN countries. ASEAN might accept making exceptions in very few industries that might be integrated later on (this was done in MERCOSUR with automobiles, yielding mixed results). While perhaps more difficult to implement, this option would have the effect of reducing transaction costs in the region substantially, mitigating any trade diversion potential of regional integration, increasing the ability of ASEAN to negotiate integration accords with other trading partners, and augmenting its clout in international organizations. It could be a critical step in turning ASEAN into a truly open marketplace.

This approach is not really foreign to ideas that ASEAN leaders have proposed in the past, e.g., the Philippine proposal to multilateralize AFTA cuts. Moreover, many ASEAN countries have committed themselves to “open trade and investment” by the year 2020 as part of the Bogor Vision of APEC. True, it is unclear exactly how the Bogor Vision will be achieved, or even what it means: APEC has not completely spelled out the details, and many ambiguities persist. However, tariffs and non-tariff barriers in ASEAN have been falling over time anyway and will continue to do so thanks to Uruguay Round commitments, potential commitments under Doha (if successful), and the liberal posture of the ASEAN leaders.

In this sense, the AEC could be recognized as a purely outward-oriented endeavor. Fortress ASEAN was never an option. Why not, then, create an essentially open region? The economic argument for protectionism is extremely weak, as ASEAN leaders have recognized. Some might continue to adhere to the infant-industry argument. But this argument has been more of an excuse for protection than a true means of efficient industrialization in ASEAN and elsewhere. There are 15 years between now and an AEC 2020; this is plenty of time for any industry to go through its transition. Besides, in order to make the infant-industry argument convincing, one must identify financial bottlenecks that prevent firms from setting up comparative advantage industries. Given the state of financial markets in at least the original six ASEAN countries, this is not a problem. Moreover, this open-market solution does not mean that governments would have to throw away their ability to foster industrialization directly, should they desire to do so. Regardless of the merits of an active industrial policy, it is still possible even in an open customs union. This is something that the European experience clearly shows. Even today, almost a decade after the completion of the Single European Act and four years after monetary union, governments still tend to have active industrial policies, e.g., through direct subsidies, special financial and tax credits, and even *de facto* administrative rules. The EU has formal restrictions on these, but they are constantly tested (e.g., the EU market in financial services is far from complete). Tariffs have always been a clumsy way to foster industrialization, and non-tariff barriers tend to be even worse.

Of course, the transitional economies pose an important problem here. Cambodia, for example, until recently received about 70 percent of its government income from import-related taxes. However, it is reducing reliance on international-trade-based taxes as part of its reform program, and this has also been the case in the other CMLV countries. Vietnam has made tremendous progress in its transition program and should be ready to join AFTA in 2006. Allowing the logical progression of this reform program to continue to 2020 will not be easy but would be quite desirable from an economic development perspective. Again, 2020 is a long way off, and much can happen between now and then; Vietnam has reinvented itself from a non-market, closed, and state-directed economy into an increasingly outward-looking, market-oriented economy in less time than it will have for the AEC. It may even be possible for ASEAN to allow for a longer-term transition period for Cambodia, Myanmar, and Laos, especially since there remain political uncertainties in these countries.

Regarding labor flows, we note that it would be politically difficult to adopt the Single European Act approach of (technically) free labor mobility. Moreover, this would not be necessary in the ASEAN context, at least from the point of view of multinationals and of integrating the region with the global marketplace. Yet, the free flow of skilled labor would be important, as would be the facilitation of visas for non-ASEAN nationals in the context of a regional framework.

However, the process will be difficult, as it was in the European case. Mutual recognition of professional qualifications, university and technical education, and the like will require a great deal of work. Yet, this process actually presents a good opportunity for the region, and especially for the CMLV countries, to embrace “best practices.” It may well be that the process will be easier for ASEAN than it was for the EU, as fewer entrenched special interests and less general resistance to reform in this area are present. Many would welcome this approach.

The idea of adopting “best practices” also extends to other areas that were important in the Single European Act, e.g., product testing, technical standards, food/health-related standards, and the like. Mutual recognition will be necessary in these areas and, hence, harmonization of at least minimum acceptable standards will have to be developed. Codes should borrow from internationally-accepted standards wherever possible.

Attracting FDI is an important priority among ASEAN leaders. The usefulness of a regional approach has been recognized from the beginning, with the (generally, failed) attempts at industrial cooperation in the mid-1970s, the (marginally more successful) initiatives of the late 1980s, and, finally, the ASEAN Investment Area (AIA) in 1998. The AIA is surprisingly comprehensive; once the exclusion lists are incorporated into the mainstream, it will have gone a long way toward creating an integrated ASEAN market, though national policies will have to be increasingly harmonized in order to create a truly regional market. There is no doubt that FDI will be a high priority in the AEC and that this vision of an integrated market for FDI will not be attainable without the transaction-costs-reducing liberalization and facilitation initiatives under other aspects of the AEC.

Free-flow of services will also be necessary, especially since services are becoming increasingly important in the ASEAN countries, a process that will continue as ASEAN countries develop. The ASEAN Framework Agreement on Services (AFAS), which takes a “GATS-plus” approach, is an important step toward creating an integrated market. Free flow of services in the AEC will merely involve an expansion in existing commitments since the third round of AFAS negotiations, which began in 2001, should at least in theory cover all sectors and “modes” of service provision defined by the OECD, that is: (1) cross-border supply, in which a company exports the service from home, e.g., by fax or email; (2) consumption abroad, in which the user of the service consumes it outside his/her home country, e.g., tourism; (3) commercial presence, in which a company directly supplies the service to foreign customers (this involves establishment of an affiliate abroad and constitutes over three-fourths of all trade in services); and (4) the presence of natural persons, in which case the service-exporting country sends personnel abroad to supply services. The AEC will ultimately have to ensure a generally open market in services, including no policy-induced discriminatory restrictions (including trade taxes), national treatment, mutual recognition, and the like. This was a difficult process in the EU, as some of these sectors remain quite sensitive. For example, in the financial services area, the Single European Act stipulated three principles for integration: (1) the observance of specific minimum requirements; (2) the mutual recognition of member states’ legislation; and (3) the prevailing of the “home country principle”, whereby the regulations of the country in which business was taking place would take precedence (rather than those of the host country).<sup>21</sup> However, not even the Single European Act has succeeded in fully integrating the financial services sector; retail banking services in particular continue to be segmented and protected on a national basis. Moreover, the “Services Directive,” which would serve to create a more integrated market in EU services (particularly in light of the EU 2004 expansion), was rejected in early 2005.

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<sup>21</sup> Story and Walter, 1997.

Hence, as the ASEAN Framework Agreement on Services is expanded as part of the AEC process, it will be necessary to integrate services sectors carefully, for the service sector is by its very nature more complicated than the goods sector. Moreover, the AFAS progress to date has been weak, and there is a reason for this: certain services are sensitive politically. Most likely, it will be necessary to exclude certain sectors from complete liberalization, but these should be kept to a minimum.

Developing appropriate institutions under which the AEC can evolve will be necessary. While the ASEAN Secretariat has come a long way, it will have to be enhanced drastically in order to facilitate the creation of the AEC. It will need to have a much larger professional staff recruited from throughout the region and with a regional—rather than national—commitment, as is the case in the EU. Many of the directorates of the EU could be emulated in the ASEAN context. But it is our view that the bureaucracy should be kept, to paraphrase Albert Einstein, “to the minimum possible but no less than that.” The first reason for this is that the EU bureaucracy is simply too big and expensive. In the second place, the drain on human capital in the ASEAN context would be detrimental to other domestic policy priorities, an important consideration for the CMLV countries in particular. Third, at least in the first stages of creating the AEC, ASEAN could keep the “social bureaucracies,” which are fairly substantial in the EU, somewhat of a separate project. While these institutions were important in making the EU what it is today, ASEAN, as noted above, is characterized by a very different socio-political context. A fourth and related point relates to the creation of a “mini-state” in ASEAN, as has been done in the case of the EU, e.g., in developing an integrated executive, legislative, and judicial system. Because the willingness within the EU to develop supranational institutions is more the exception than the rule, in our view ASEAN should try to minimize the supranational character of AEC, taking the idea of “subsidiarity” to the greatest extent possible. The executive component of ASEAN integration would have to be enhanced considerably, but this could arguably be done by adapting and expanding current institutions. On the other hand, the creation of some sort of judicial authority to “enforce” (hitherto a bad word in ASEAN) AEC rules will be necessary. No doubt this will be difficult; the EU continues to have its own problems (e.g., the Alstom case in France is a good example, but there are many more). As in the case of the EU, it would have to be an evolutionary process.

The Asian Crisis has underscored the need for greater monetary and financial cooperation, given the importance of these areas to future regional economic development and their importance in supporting initiatives in the real sector. This differentiates it to some degree from the EU experience, in which financial/monetary cooperation came later. Moreover, the fact that ASEAN’s trade and investment links are dominated by partners outside the grouping would suggest that the recent widening of cooperation outside of strictly ASEAN-based institutions to include China, Japan, and South Korea gives it a much greater incentive to promote cooperation in the area of financial and monetary integration, no doubt a reason for the popularity of the ASEAN+3 initiatives.

## ***V. Concluding Remarks***

In this paper, we have tried to consider what the objectives and substance of the AEC should be, using wherever possible appropriate lessons from the world’s most successful example of regional economic integration, the European Union. We note that while there is much that the EU can teach ASEAN, ASEAN leaders should not underestimate the differences between the regions and the differing historical contexts.

The EU integration experience is remarkable. It took a great deal of time before it became a truly integrated market—about 37 years from the Treaty of Rome in 1957 until the implementation of the Single European Act, which was essentially complete in 1994. Once the process was given a big push in the mid-1980s, however, integration initiatives picked up steam, culminating in monetary union only five years after the promulgation of the Single European Act.

At times, some leaders and experts gave up on the EU; the process certainly was familiar with “crisis”. In 1976, for example, France (temporarily) slapped import tariffs on Italian wine. In the early 1980s, market segmentation increased with the use of non-tariff barriers outside the purview of the EC, leading some to suggest that the EC was doomed to retreat. After the September 1992 crisis in the EMS, it was very easy to be pessimistic about the future of monetary union. There were skeptics up to the very the end.

But the EU was able to persevere due to the commitment of its leaders and critical social elements. This is a very basic lesson: given the fact that the AEC will have to be far more comprehensive and “intrusive” in national markets than has ever been the case before, it will take strong commitment, indeed, in order to move the process forward.

No doubt this is why there is much skepticism regarding the AEC. It was no different in the case of AFTA: in the late 1980s, many pundits were speculating that since the region’s political exigencies had changed, ASEAN had no future as a regional organization. Instead, the ASEAN leaders responded by pushing forward impressively on the economic front, and AFTA became the first major initiative in this process. Since then, AFTA has expanded and deepened, cooperation has advanced significantly in the area of investment (AIA), liberalization of services is being actively pursued in the ASEAN Framework Agreement on Services, other “deepening” measures are being spearheaded, and horizontal integration has expanded about as far as it can go, as ASEAN is now composed of all 10 Southeast Asian nations. While the AEC will take a much more extensive commitment, it can certainly be realized if the ASEAN leaders have the political will to see it through.

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