

## Chapter 1

### Introduction and purpose<sup>1</sup>

Understanding ASEAN's economic integration model is a genuine challenge. A fundamental reason why conceptual and other difficulties arise in the case of the ASEAN Economic Community (AEC) is that ASEAN architects observe two stylised (regional) economic integration approaches in the world which they do *not* want to pursue: the 'EU model', which is supranational, far too ambitious and also to a degree 'open-ended' in terms of further ambitions, and the classical free trade area (FTA) approach, even when upgraded a little nowadays. Another reason for conceptual puzzles is found in ASEAN's strategic (development) preference of hooking up to global value chains, without a firm view on how such a strategy relates to 'deep' economic integration. Within the framework of the ASEAN Integration through Law project, the purpose of the present monograph is to try to make the ASEAN economic integration model intelligible

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by applying a *conceptual* approach. This conceptual approach is drawn out in considerable detail, but it is also ‘tested’ by providing a wealth of factual detail about how ASEAN implements the AEC. The merit of the conceptual approach is, above all, that the numerous technical and often highly specific measures, as well as the many ASEAN ‘principles’ and ‘guidelines’, not to speak of detailed Roadmaps, can be understood in context and their economic and practical significance for market players better appreciated. Given the ASEAN ‘way’ of building up commitments, whether for the former AFTA or now for the AEC, it is exceedingly difficult to make (over 500) elements of the AEC Roadmap intelligible and give them a ‘place’. However, right from the start, it is crucial to appreciate that the AEC is based on two concepts, presented as parallel: the ‘single market’ and (ASEAN as a) ‘production base’ for segments of global value chains. Whereas the single ASEAN market has at least been defined with respect to some key properties (such as ‘free flows’), this is not the case for the ‘production base’. It is also exceedingly difficult to trace authoritative statements about, let alone a legal basis for, the political priority of one concept over the other, or how the two concepts are linked, say, by some minimum overlap of measures or otherwise. This generates a profound problem for this monograph: in focusing on the ASEAN economic integration model, we risk reading more into ‘the’ single market than might be warranted, for the simple reason that ASEAN’s implicit development aims are overriding and this may well prompt a bias towards the ‘production base’. The greater the bias in favour of the ‘production base’, the greater the temptation for ASEAN decision makers to regard the single market

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programme as serving the ‘production base’ as well, thereby rendering the single market programme less coherent and more difficult to comprehend in terms of integration logic. Stronger, this lesser coherence or greater incompleteness or selectivity in addressing problems which, in an integration strategy, would need to be tackled convincingly, might not even be seen as a problem by ASEAN leaders or business. What might matter most to them is a medium or even long-run growth prospect for the region and, if the production base is expected to be growth-enhancing in a powerful way (as experience in East Asia suggests), the single market as a ‘concept’ may well be downgraded in actual practice. Since global value chains thrive on ‘openness’ of economies and easy market access (in particular, in East Asia), market access in East Asia via FTAs might rank as high or higher for the success of the ASEAN production base than the pursuit of an ever deeper – indeed, ‘single’ – internal ASEAN market. The present monograph will focus on the ASEAN economic integration logic from a conceptual point of view, but the intricate and multifold linkages with measures relevant for ASEAN as a ‘production base’ cannot be left out.

The ASEAN Economic Community might be called a ‘vision’ if one reads the 2003 Bali Concord. It contains plenty of conceptual elements which can be analysed separately as well as jointly. Nevertheless, when going from an avowed ‘vision’ to the scrutiny of what exactly the AEC is and/or is meant to be, it becomes harder to comprehend its concepts, the way(s) they hang together and its ‘final’ economic integration ‘model’. Perhaps this is not surprising. The ‘ASEAN way’ has never given primacy, so far, to logic

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and rigorous conceptual models, but usually amounts to pragmatic responses – mainly to external pressures – and under political constraints such as far-reaching respect for national sovereignty and a search for consensus. The initial approach, quite general at the outset, is typically refined or ‘deepened’ later, again pragmatically, step by step, and taking care that consensus is not undermined. Of course, the present study will not ignore such constraints and traditions.

Nevertheless, the queries addressed are conceptual. The justification for conceptual analysis and scrutinising integration logic is that economic integration, and even more so ‘deep’ economic integration, can tolerate only limited degrees of incompleteness and only so many inconsistencies. Not only are ‘half-way houses’ and serious inconsistencies affecting the credibility of integration with business and citizens – once credibility is lost, the entire integration attempt might well become pointless from an economic point of view – they will also generate never ending pressures, frictions and perhaps even tensions which might eventually sap the energies needed for intense cooperation and convergence. Indeed, in ASEAN, economically so dependent on the world economy and more and more on East Asia, national political and negotiating energies might instead be spent on deeper relations with external partners.

The present contribution to the ASEAN Integration through Law project aims to scrutinise the concepts, logic, sequencing, coherence and options for the 2015 AEC. This is supplemented by extensive scrutiny of what has actually

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been accomplished (and not) for realising the AEC, until recently. The author will assume an economic perspective, whilst taking due account of institutional, legal and political economy aspects where essential. Economic integration processes largely take place in markets. Nevertheless, it is difficult to escape from the notion that a political desire to pursue (ever) 'deeper' economic integration requires (ever) more demanding regulatory, economic policy, political and institutional as well as legal commitments by participating countries. Building on the ASEAN Free Trade Area (AFTA), a classical FTA based on (practically) zero intra-AFTA tariffs and liberal origin rules, the pursuit of an AEC will significantly raise ambition and widen the scope of the policy spectrum for economic integration. This is bound to extend decision-making from trade (and 'ASEAN') ministers to broader government policies and reforms of standing economic regulation practices. Assuring 'deeper' economic integration is therefore very different in nature than fixing a classical FTA. It must imply domestic reforms and possibly a shift to regulatory regimes distinct from those applied today in ASEAN countries, besides the acceptance of a range of ASEAN 'disciplines' going far beyond those of the GATT and GATS.

The book has seven chapters. Following this introductory chapter, Chapter 2 deals with the foundations of economic integration. It will discuss five 'fundamentals', recall the modern version of the 'stages approach' to economic integration and its relevance for the AEC, and address the intricate yet critical issue of credibility and transparency to market players. Going into the foundations is inspired by

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the ‘vision’ and labelling of the conceptual elements of the AEC, toying with some of the constituting elements of the 1957 EEC (Rome Treaty). But it can also be read as a stand-alone reflection. Chapter 2 also addresses the strategic choices and economic rationales of the AEC. First, the AEC and NAFTA are compared in section 2.4 as to four strategic choices for the integration model. The main query is whether the AEC can develop an equally compelling integration logic as that of NAFTA, hinging on the answers to those four strategic choices. In section 2.5, the query is what are the economic rationales for the AEC, in particular given its pursuit of its medium- and long-term socio-economic aims. Two partly overlapping economic perspectives will be reviewed: one economic rationale is an ASEAN-led development strategy rendering ASEAN more attractive for global value chains, the other is a quasi-single market strategy as a pro-competitive underpinning of economic development. Chapter 3 is driven by the question ‘what exactly is the AEC?’ Discovering what the AEC is may be regarded as a descriptive exercise – which it is, no doubt – but it will also require quite some exegesis and interpretation. Section 3.1 recalls and stylises the Bali Concord and the High Level Task Force (HLTF) recommendations. In section 3.2 an attempt is made to grasp the contents and economic meaning of the Bali ‘vision’ on the basis of a series of conceptual questions. Section 3.3 discusses the five economic concepts of the Bali AEC ‘vision’, whereas section 3.4 provides a summary of the AEC Roadmap drawn up several years after Bali. Chapter 4 zooms in on the ‘hard core’ of the AEC in the Roadmap, taking into account the progress made

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in implementing the plans up to spring 2013. Since the Roadmap is a lengthy document with nearly 300 steps in many domains, the analysis amounts to a painstaking exercise for the reader, yet it is indispensable for a profound understanding of the substance of the AEC as foreseen by its architects. The exercise demonstrates that it is difficult, indeed somewhat arbitrary, to attribute the various Roadmap features to the ASEAN single market or to ASEAN as a regional production base. It also shows that the AEC strategy has compelled ASEAN to work on its complexity and sub-agendas much more than was perhaps foreseen at the Bali ASEAN summit. Chapter 5 provides a reality check by comparing the ASEAN AEC with NAFTA in greater detail. The comparison is made with the help of a lengthy table for fifteen of the main areas of the NAFTA treaty, compared with the status for these areas in the AEC (with quite some detail per area) and a brief comparison with the EU as well. The table helps to demonstrate that the AEC and NAFTA are not far apart, except for a few areas where ASEAN would have to raise its credibility. Chapter 6 suggests three stylised options for the AEC, close enough to the 'vision'. The idea is to obtain coherence within every stylised option and to consider some trade-offs. The term 'economic integration model' should be understood in a flexible way, given ASEAN's strong preference for more and higher value-added participation in global value chains enabled via its regional production base. Chapter 7 concludes.

## Chapter 2

### Foundations of economic integration fundamentals, stages and credibility

In attempting to understand the AEC and grasp its full potential as well as its limitations, it is indispensable to first go through a careful identification of the foundations of its possible economic integration model. We shall do this by: (a) articulating the fundamentals of any economic integration and discussing their relevance to the AEC; (b) linking the (modern) stages approach to economic integration to the AEC ‘vision’; and (c) addressing the intricate, yet critical, issue of credibility and transparency to market players.

#### **2.1 Fundamentals of economic integration and the AEC**

When (regional) ‘economic integration’ is intended to move significantly beyond, say, a classical FTA in goods, it becomes more and more crucial to first appreciate several fundamentals. A non-exhaustive list of such fundamentals includes: (i) the political framework; (ii) the long-term commitment of the participating countries, expressed in credible treaties or otherwise; (iii) the level of development and/or the disparities in prosperity and capabilities; (iv) the ‘economic order’, in particular, the respect for market-driven incentives; and (v) some form of



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implicit or explicit consensus on the comprehensiveness or selectivity of economic integration.

*2.1.1 The political framework*

For 'deeper' economic integration to be meaningful, governments and political leaders have to assume a long-term perspective. They have to be seen as willing to accept, at least to a non-trivial degree, the domestic consequences of 'deeper' integration. A failure to do so will not only leave major gaps or omissions in what that Member State is committing to, but will reduce, at the same time, the preparedness of partners to further the process. It will equally damage credibility with market players, who have to exploit the promised opportunities and generate the prosperity gains sought. Of course, socio-economic and political sensitivities are a reality almost everywhere in the world, and various formulae can and will be employed to cope with such problems. One may mention agreed exceptions, exemptions and delays, though all of these run into their natural limits – otherwise the economic integration pursued will simply not emerge. One may allow the ASEAN-X formula, or (what Europeans call) 'géométrie variable' or differentiated integration, but these cannot be pushed too far and will eventually have to be addressed, if not overcome, to a considerable extent. With all the finesse and variations in the integration process between governments, there is no escape from the dictum that the political framework required for significantly 'deeper' economic integration has to be sufficiently firm and credible. Insisting on 'sovereignty' (whatever that means in today's world economy)

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as an *a priori* for many policy domains affected by deeper integration basically amounts to a denial of the ‘depth’ of economic integration. For ASEAN countries, claims of nation-building and national development strategies are understandable, and their resonance with the electorate is probably still great. This artefact renders ‘deeper’ economic integration, already difficult by its very nature, even more challenging for ASEAN countries.

In Eurospeak, the insistence on an ‘intergovernmental’ approach, driven by widely felt preferences to retain a great deal of national economic policy autonomy, risks being at odds with the very goal pursued. The AEC will have to cope with this fundamental question not only today (in 2015), but also later. Employing intergovernmentalism for the AEC has three distinct (though related) aspects, and all three have to be carefully considered: (a) intergovernmentalism is politically heavy-going and slow, in particular, when there are no overarching ‘mother principles’ to which all Member States are bound and can be held accountable; (b) relying on intergovernmentalism *without* having, at the same time, carefully construed forms and capabilities of integration which are centralised is much harder than a well-considered combination of centralised and intergovernmental decision-making – this combination has the great advantage that the remaining degrees of national economic autonomy tend to be well protected (which is what national politics wants to see), whilst the cumbersome search for consensus does not affect the hard core of ‘deeper’ economic integration any longer; (c) intergovernmentalism is also inefficient, if not outright impractical or ineffective, in terms of administration, monitoring, the