

## Chapter 1

### Introduction

This book provides a critical overview of the efforts of the Association of Southeast Asian Nations (ASEAN) in its ASEAN Economic Community (AEC) project and the existing agreements and institutional tools available to ASEAN in constructing the AEC. The focus is on the intra-ASEAN foundations of the AEC, examining both the language and substance of the underlying agreements, as well as the institutional arrangements currently in place.

A necessary premise to the introduction of this book is that the ASEAN Charter and the related ASEAN agreements and protocols are examined in the light of their objectives of achieving economic integration, more specifically a single market and a single production base according to the objectives of the ASEAN Charter.

It has to be recognized that trade and economic integration was not a founding pillar of ASEAN. The Bangkok Declaration of 1967 establishing ASEAN was focused on political and diplomatic cooperation in Southeast Asia, in the context of the Cold War. However the fact that objectives of economic integration are becoming an important aspect of ASEAN and are explicitly included in the ASEAN Charter, adopted forty years later in 2007, demands a revisiting of the ASEAN instruments to assess whether ASEAN has matched economic integration objectives with the necessary means to achieve them.

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### 1.1 Single market and single production base: prioritizing

The attitude of Asia toward regional trade integration may be best summarized by the motto “Where markets lead, governments are following.”<sup>1</sup> Indeed Southeast Asian perception and political impetus toward trade integration has always been geared by de facto market integration rather than formal trade integration understood as trade agreements and free trade areas. This is somewhat different from European and North American experiences where governments took the lead in designing the Treaty of Rome of 1957 in Europe and its most recent successor, the Lisbon Treaty for the formation of the European Union (EU), and in the North American Free Trade Agreement (NAFTA) of the United States, Mexico, and Canada.

The belief in market integration that exists in Asia stems from Asia’s trade and investment ties that were particularly pronounced since the 1980s and are nowadays particularly advanced. Regional integration of production has become central to Asia’s leadership in global manufacturing. As production chains are broken into a fragmentation of production, with each step produced in the most cost-efficient location, Asia’s manufacturing chains have become a key asset in attracting global investment and production.

Thus, the ASEAN Charter notes that the aim of the region’s economic integration is to “create a single market

<sup>1</sup> See Asian Development Bank, *Emerging Asian Regionalism: A Partnership for Shared Prosperity* (Mandaluyong City, 2008) p. 11, <http://aric.adb.org/emergingasianregionalism>

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and production base which is stable, prosperous, highly competitive and economically integrated” in paragraph 5 of Article 1. The “single market” and the “single production base” are correctly identified as two separate concepts in the Charter: (1) the “single market” for goods, services, labor, investment, and capital, and (2) the “single production base,” to create products for export.

In the opinion of the authors and given the reluctance of ASEAN member states to relinquish powers for the establishment of a single market, the ASEAN Charter inverted the significance of the AEC’s integration goals. As the analysis of the AEC texts and the ASEAN Trade in Goods Agreement (ATIGA) further below will demonstrate there is simply no trace in the AEC of the tools and legal instruments indispensable to establish a single market. Thus it is more realistic to assume that the drafters of the AEC meant, beyond the fanfare of the single market, to establish something nearer to a single production base.

Given the economic disparities and lack of economic cohesion among ASEAN members, both in terms of development and size, a single market should not be necessarily a first priority, at least in the near-to-medium term. The income gap between the ASEAN member with the highest GDP per capita (PPP), Singapore, and the ASEAN member with the lowest GDP per capita (PPP), Myanmar, remains at 50:1.<sup>2</sup> By contrast, the ratio in the EU of its highest GDP per capita

<sup>2</sup> Report for Selected Countries and Subjects, International Monetary Fund, available at [www.imf.org/external/pubs/ft/weo/2012/01/weodata/weorept](http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weorept)

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member, Luxembourg, and that of its lowest, Bulgaria, is only approximately 7:1. Furthermore, the majority of ASEAN's population is in countries classified as Less Developed Countries (LDCs).

Unlike the EU, therefore, the ASEAN drafters of the AEC may have considered that achieving a single market should not be viewed as the end objective of economic integration. Yet there is no definition in the AEC text of what a single production base is. Thus the authors assumed, following conversation with ASEAN officials, that a single production base is a zone which would supply ASEAN products for consumption not just in ASEAN but for export to elsewhere in the world.

Hence, like NAFTA, integration through the AEC should be viewed as a means to an end. Establishing a more effective, harmonized production base through AEC measures will encourage foreign and domestic investment in production assets in ASEAN, with the resulting products both consumed within ASEAN and exported abroad. The general population in ASEAN will benefit to the extent that increased investment results in higher employment, wages, and overall development. ASEAN leaders appear to understand this aspect of economic integration, as denoted by their repeated calls for greater involvement by small and medium-sized enterprises (SMEs) and ASEAN-owned businesses in regional integration. Without improved participation by this sector of ASEAN's economy, the benefits of regional economic integration will remain concentrated in limited segments of the economy that have already integrated, such as automobiles and electronics, which are mainly dominated by Japanese

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multinationals. In that way, perhaps, one does not need to wait until December 31, 2015, to see the AEC in operation. One may argue that a limited form of the AEC already exists, at least for Japanese electronics and automotive industries, which already operate on a regional basis within ASEAN. The negative consequences of such domination were borne out, on a micro level, during the 2011 Bangkok floods; the disruption inflicted on key Japanese-owned plants located in the Bangkok area caused adverse downstream effects on a global basis. Expansion of the regional economic integration efforts to all aspects of ASEAN society is also necessary for political and social stability within the regional bloc. In other words, expanding the coverage of the AEC is necessary to support the other “pillars” of ASEAN, the political–security and sociocultural pillars.

Thus, focusing on the single production base will allow ASEAN to diversify its production base in terms of industries and participants. It also will allow ASEAN to be more competitive relative to other investment destinations such as China and India, which are ASEAN’s most immediate competitors. Perhaps best of all, focusing on the single production base is a more feasible and modest target for ASEAN policymakers with relatively less political and economic hurdles to surmount. Yet the AEC and related ASEAN legal texts are far from providing the necessary foundations to establish a single production base.

In establishing the necessary reforms of the AEC and the ASEAN legal texts it would be better, in the authors’ view, to assign priority to the single production base first, where the political and bureaucratic battles can be more easily won, with

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political and economic allies both within and without ASEAN (e.g., producers and investors who will benefit from the greater economies of scale). Devoting time and energy in a diffused manner to an ambitious goal such as developing a single market when ASEAN member states are reluctant to relinquish sovereignty is simply unrealistic. Countries in the ASEAN market have such great disparities of purchasing power and abilities to regulate and administer the market that the establishment of a single market would be a draining, frustrating process, with few or undeveloped allies in the process (e.g., the ASEAN consumer may benefit from a single market, but the voice of the ASEAN consumer will continue to be relatively weak until that market matures). This is especially the case when the major issues to be addressed with regard to both the single production base and the single market in the AEC are largely issues regarding the movement and flow of goods, services, and investment beyond the national borders. Post-entry barriers to economic integration are more difficult to identify, resolve, and monitor, necessitating some prioritization of goals in the AEC integration process.

That is not to say that the single market should be disregarded. Rather, it is to say that the single market will progressively arise by its own accord based on the policies of ASEAN in developing the AEC. Companies and their employees involved in the single production base will have greater spending power in the single market, and suppliers who integrate to serve the single production base will also have greater efficiencies in selling to the single market.

The question thus arises whether ASEAN's institutions and legal texts are sufficiently developed to support the

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development of the single production base and the single market in the AEC. Without formal institutions and/or formal documents, the obligations, and responsibilities of the participants in the AEC, e.g., the governments, producers, sellers, and consumers, will remain vague and ill-formed, a situation hardly conducive to full formation of the AEC.

**1.2 Matching the institutional tools to the AEC goals**

Progress in economic integration in Asia is not reflected in formal trade liberalization. The relative lack of progress in formalizing economic integration hampers both the formation of a single production base and of a single market. In spite of decades of trade liberalization under ASEAN tariff liberalization initiatives and market integration under the Greater Mekong Sub-region (GMS), there is still much red tape that exporters encounter at customs or with ministries of finance and some of it is exhaustive.<sup>3</sup> Even with zero tariff rates, intra-ASEAN trade will not see a boost unless ASEAN member states remove all the red tape at the border and beyond. In some ASEAN countries, delays caused by bureaucratic procedures for exports last 22–29 days, a United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) study revealed. The average number of documents and time required for import/export in many

<sup>3</sup> ESCAP, *Regional Trade and Investment: Trends, Issues and ESCAP Responses*, doc. E/ESCAP/65/2, January 29, 2009, p. 11, [www.unescap.org/EDC/English/Commissions/E65/E65\\_2E.pdf](http://www.unescap.org/EDC/English/Commissions/E65/E65_2E.pdf)

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Asian subregions remain well above the developed country average.<sup>4</sup> Liberalization of trade in services in the region in spite of the ASEAN Framework Agreement on Services (AFAS) remains limited, especially when compared with other regions.

While the support for the integration of Asia's production networks has made substantial progress, integration by law has lagged behind, at least when compared with the Western models. Much remains to be addressed for the creation of an open, rule-based ASEAN system of trade and investment rules in the region. With such a system, it will be much easier for ASEAN to complete both the single production base and the single market in a manner that spreads the benefits of the AEC to all sections of society, not just those industries which are already integrated on a regional basis. Unless the benefits are spread to all of ASEAN society, the political support among the general population for the AEC, and in ASEAN in general, will dissipate.

This is an area where policymakers and leaders in the Asia region at large have yet to pay substantial attention. The Asian region had not been particularly active on the movement toward formal regionalism especially compared to other regions. ASEAN was one of the few regional agreements in Asia that has existed for various decades representing a major initiative, and yet it has systematically refrained from establishing the institutional tools and a systemic rule-based

<sup>4</sup> See Macan-Markar, above n. 3, interview with R. Ratnayake, director of the trade and investment division at the Economic and Social Commission for Asia and the Pacific (ESCAP), [www.unescap.org](http://www.unescap.org)



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system with delegation of powers to achieve economic integration. The Asia Pacific Economic Cooperation (APEC) process is relatively recent and it is not a free trade area in the strict sense of the term. The Trans Pacific Partnership (TPP) is a free trade area that would be based on more formal textual obligations, but the TPP has a more limited geographical reach and a time frame that may take years to complete.

By early 2000, the Asian region witnessed an unprecedented flourishing of formal bilateral and plurilateral initiatives aiming at establishing various forms of free trade area agreements or regional initiatives. Both Japan and Korea, for instance, had traditionally held to the principle of multilateral liberalization in the World Trade Organization (WTO).<sup>5</sup> Yet Japan has embarked on a significant shift since 2002 and has now entered into a series of free trade agreements called Economic Partnership Agreements (EPAs) encompassing trade in goods and services as well as other disciplines.

Normally free trade areas involving major trading nations like Japan, Korea, and the USA are based on formally negotiated agreements resulting in substantial trade liberalization on trade in goods but increasingly encompassing trade in services, promotion of investment, mutual recognition of standards, and other forms of economic activities extending to competition laws and intellectual property rights. These agreements are generally compatible with WTO rules on free trade agreements (FTAs), namely Article xxiv of the General

<sup>5</sup> In the case of Japan, see M. Matsushita, "Free trade agreements in East Asia within the disciplines of the WTO-Japan's experiment," paper presented at the High Level meeting on the WTO trading system, Asian Development Bank, August 2002.

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Agreement on Tariffs and Trade (GATT) and Article v of the General Agreement on Trade in Services (GATS), with time limits and deadlines for implementing the trade liberalization commitments entered into by the parties. Such is the case, for instance, of the EPAs that Japan has entered with ASEAN countries. In addition ASEAN has also entered into a series of FTAs of this kind with Australia–New Zealand, and the Republic of Korea albeit not as extensive in coverage as in the case of the EPA with Japan.

These latest FTAs entered into by some ASEAN countries contain a rather comprehensive normative approach of the issues covered from rules of origin to trade in services. However there has not been any spillover effect of this normative approach on agreements governing trade within ASEAN itself. In other words ASEAN continued its “ASEAN way” of less formal obligations and responsibilities with regard to its own internal trade, with no lessons learned, remaining unscathed.

In the case of South–South agreements the notion of a free trade area, the extent of trade liberalization, and the implementation of the commitments vary hugely.<sup>6</sup> Even the most traditional form of trade liberalization, i.e. tariff dismantling, still requires a considerable amount of attention and negotiations, also in the ASEAN context, and this after decades since its establishment. Different models of regional integration coexist in the region. The ASEAN and the GMS

<sup>6</sup> For a discussion on these issues, see International Bank for Reconstruction and Development/World Bank, *Global Economic Prospects 2005: Trade, Regionalism and Development* (Washington, DC, 2005).