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Introduction
ASEAN — Towards Economic Convergence

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1. ASEAN: Historical Background and Objectives

The Association of Southeast Asian Nations (ASEAN) was founded in Bangkok on 8 August 1967. It was originally designed as a political entity to establish cooperation among the free market economies of Indonesia, Malaysia, the Philippines, Singapore and Thailand to peacefully resolve several areas of tension among these countries at that time[1] and to combat the communist threat that was looming from Indo-China. North Vietnam had already fallen to communism, while the communist struggle for control of Cambodia, Laos and South Vietnam was ongoing. Although there were hints of communist revolutions in the original ASEAN countries, the fall of Cambodia, Laos and South Vietnam did not carry through to them, disproving the then famous "domino theory" that the communist contagion would absorb the other countries in Southeast Asia. Economic reforms in Communist China following the political ascent of Deng Xiaoping in 1978 was the surprise development that largely ended the threat of spreading communism in the region. Hence, apart from attempting to play a foreign policy role through cooperation among members, ASEAN efforts to strengthen cooperation to ward off political threats began to decline since the late 1970s. In fact, the communist economies reverted to introducing reforms to integrate with the global economy since the 1980s. Thus, Vietnam joined ASEAN on 28 July 1995; Lao PDR and Myanmar joined on 23 July 1997; and Cambodia joined on 30 April 1999.

The key agreement that defines the conduct of ASEAN members is contained in the Treaty of Amity and Cooperation in Southeast Asia (TAC) of 1976 (ASEAN 2018). Its key tenets include:

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- Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;
- The right of every state to lead its national existence free from external interference, subversion or coercion;
- Non-interference in the internal affairs of one another;
- Settlement of differences or disputes in a peaceful manner;
- Renunciation of the threat or use of force; and
- Effective cooperation among members.

The vacuum created by the fading political interests that resulted with the resolution of intra-ASEAN tensions and the end of the Vietnam War was replaced by a strong surge in economic cooperation. The initial focus was on joint, heavy-industry projects among members, including in the production of fertilizers and chemicals. The Declaration of ASEAN Concord signed in Bali, Indonesia on 24 February 1976, stipulated that member countries shall take cooperative action in their national and regional development programmes, utilizing as far as possible the resources available in the ASEAN region to broaden the complementarity of their respective economies (ASEAN 1983). This was then followed by the Basic Agreement on industrial joint ventures that was signed in Jakarta on 7 November 1983 by the founding members to collaborate for: acceleration of economic growth; promoting greater utilization of regional agriculture and industry; expansion of trade; and improving economic infrastructure for mutual benefit in the region. The most engaging instrument launched was the ASEAN Free Trade Area in 1992 through the implementation of the Common Effective Preferential Tariffs (CEPT) by all the members. Lastly, the ASEAN Industrial Cooperation Scheme (AICO) was launched in 1996, which was aimed at stimulating rapid industrialization in the region through collaboration between two or more members targeted at expanding trade and investment, and for improving the economic infrastructure for mutual benefit of their people (ASEAN 1996).

2. ASEAN, Economic Reforms and Globalization

The move to promote economic integration among members gained momentum when the individual national leaders recognized the traction ASEAN as a whole had received in the international arena. The initial concerns over the emergence of exploitative international economic relations were averted through the recognition that individual members were accorded total autonomy over: first, national sovereignty; and second, the extent and nature of engagement they chose to undertake. As the advantages of trade and investment relations became obvious, many of the least advanced countries within and outside ASEAN began introducing market-oriented reforms to spearhead economic development. Nevertheless, the counter arguments on the shortcomings of free trade were also potent as the *dirigistes* argued that selective interventions drove the rapid growth experience of South Korea, Singapore and Taiwan (see Amsden 1989; Wade 1990; Chang 2003; Reinert 2007; Amsden and Chu 2003). Kim (1997) and Rasiah (1995; 2018) further added that both incremental and radical innovations through a strong focus on adaptations and R&D were instrumental in supporting technological catch up and economic development of these countries. Moreover, dissatisfaction with globalization has taken on new dimensions since the early twenty-first century, with Stiglitz (2002) capturing some of the sources of this discontent. The threat of protectionism and the attacks on multilateralism in recent years are visible signals. ASEAN has, in a sense, shown the way to move forward — while it has kept its objective to promote free trade, it has done so in a concerted and collaborative way.

3. The Arguments for Free Trade

ASEAN's reliance on free regional trade as a means to development merits a closer look at the arguments on free trade. The following is a historical and theoretical, though by no means exhaustive, discussion on the topic. The early exposition in support of markets and free trade can be traced to Smith (1776) and Ricardo (1817), and more recently to Heckscher (1935) and Ohlin (1952). Subsequent refinements by Rybczynski (1955), Stolper and Samuelson (1941), Balassa (1967), Dixit and Norman (1980), Baghwati (1964; 1968), among many others, and the counter arguments posed by the "new trade theory" of Helpman and Krugman (1985), Grossman (1992) and others have made the discussion on free trade one of the most vibrant areas of economics.

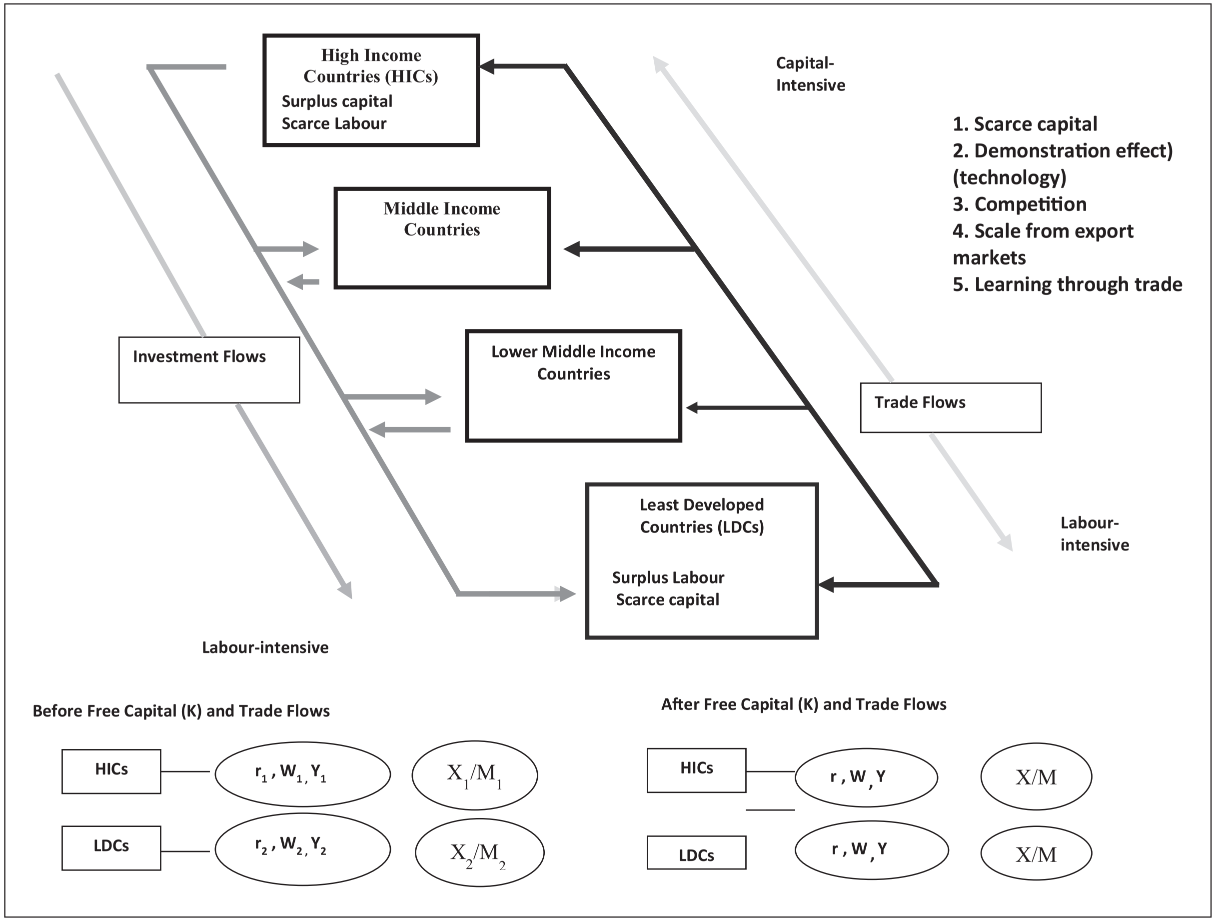
Well known as stark defenders of free trade, Bhagwati, Krishna and Panagariya (1991) discouraged regional trade blocs by arguing that they may create obstacles for global free trade efforts. To be precise, the argument is based on whether regional agreements divert or promote trade with the rest of the world. If the latter is the case, then regional trade agreements can be compatible with free trade. Although ASEAN has promoted regional integration, it has not lost sight of the wider goal of competitiveness and connection with the rest of the world. It can be argued that this has been the basis for achieving economic growth and convergence in ASEAN. The Association's support for international trade can be examined from the objectives of the World Trade Agreement that was launched in 1995 after the Marrakesh Declaration, which sought to establish free trade across the world, and eventually include the indirect flows associated with free trade, such as investment and government procurement. Although arguments on new trade theory have often advocated some elements of protection to quicken economic growth, in ASEAN, this has implied an emphasis on export orientation rather than import substitution.

As a simple explanation of the logic behind free trade (including within a regional block), consider the schematic presentation of Bhagwati and Brecher's (1980) model (Figure 1). As it is now, the ASEAN Economic Community (AEC) has in place the Common Effective Preferential Tariff (CEPT) targeted at establishing free trade among member countries,[2] and a rule of origin condition of 40 per cent value added to access preferential tariff exemptions. Despite the cumbersome application of customs procedures and intellectual property rights regulations as well as the reintroduction of non-tariff barriers, ASEAN members have proceeded to deregulate trade and investment flows across borders.

Before going into the model, it is important to pose some caveats to its real-world application. The smooth evolution of the economic convergence model advanced by Bhagwati and Brecher (1980) rests on the application of flexible exchange rates that Mundell (1963) and Fleming (1962) had advocated. Apart from exogenous disturbances, nominal exchange rates are assumed to adjust with changes in the fundamentals behind real exchange rates so that chronic trade imbalances do not occur. Moreover, the model assumes that investors and countries follow a stable trajectory of sustainable indebtedness and contract enforcement. Such a stable system, however, cannot be taken for granted. Scarcities in critical commodities, such as oil and gas, as well as soaring external debt can undermine the stability of such a system. The objective of international organizations, particularly the International Monetary Fund (IMF), is to protect the world's financial stability. Once individual members lose the capacity to service external debt and settle current account deficits, they can be forced by foreign creditors to approach the IMF, which often imposes stringent belt tightening measures through its structural adjustment packages before any bailout.

Consider now the model illustrated in Figure 1. Prior to the introduction of free capital and trade flows conditions, wages (w_1) in High-Income Countries (HICs) will be much higher than wages (w_2) in Less-Developed Countries (LDCs), while interest rates (r_1) in HICs will be much lower than interest rates (r_2) in LDCs, reflecting the scarcity and abundance of the factors of production in these countries. HICs are characterized as capital-surplus and labour-scarce economies, while LDCs are capital-scarce

FIGURE 1
Neoclassical Globalization Economic Development Convergence Thesis



SOURCE: Bhagwati and Brecher (1980).

and labour-surplus economies. Also, per capita incomes (y_1) of HICs will be much higher than per capita incomes (y_2) of LDCs.

The introduction of free trade and investment through deregulation prompts capital from HICs to flow out to developing countries, and LDCs to hire the surplus labour. The initial impact of this capital outflow will see a relative fall in wages and rise in interest rates in HICs. In LDCs, the high unemployment or underemployment rates will start to fall first. Then, interest rates will decrease and wages will rise gradually as the countries begin to develop from increased inflow of investment. Capital flows will continue to occur until an equalization of wages, interest rates, and per capita incomes occurs.

Whereas the composition of exports ($X_1 = M_2$) from HICs to LDCs will consist of capital and intermediary goods and final consumption goods, the exports ($X_2 = M_1$) from LDCs to HICs will comprise raw materials (including primary commodities), and labour-intensive light manufactured exports. At this point, a second set of caveats applies to the model. There is evidence of volatile external shocks and debt overhang affecting liberalizing economies because of the problems of "Dutch Disease" (Corden and Neary 1982) and "Fallacy of Composition" (Prebish 1949; Singer 1950) when the affected countries become dependent on a narrow range of commodities, or when governments do not take the right measures to mitigate the situation (Rasiah, Osman and Alavi 2000). These issues are not considered in this exposition, emphasizing for ASEAN the positive synergies articulated by neoclassical economists through deregulation and competition.

In the long run, with the continuous outflow of capital from HICs to LDCs and with wages, interest rates and per capita incomes equalized, the composition of imports (M) and exports (X) of both sets of countries would become capital- and knowledge-intensive, with specialization based on resource endowments — both natural and man-made. In the presence of flexible exchange rates, currencies would depreciate or appreciate to correct trade and current account imbalances.[3] Until LDCs reach the technology frontier, they will largely focus on importing foreign technology rather than targeting domestic R&D activities. Governments of these countries are expected, instead, to focus on infrastructure development, human capital, and institutional governance to facilitate technological adoption, employment, production, as well as investment and trade flows (Summers 2003; Rodrik 2011).

4. Issue Outline

Elegant as the framework depicted in Figure 1 is, it cannot adequately characterize ASEAN's role, even in the economic arena. Thus, while the flow of goods and investment (and their impact on prices) is captured by the framework, the movement of people — a contentious issue affecting the implementation of the AEC — has not been covered (Syed Munir 2018). The major shortcomings of market economics have already been articulated in detail by others (see Keynes 1936; Passinetti 1981; Stiglitz 2002). However, the gap left uncovered is much larger and goes beyond the discipline of economics. It should not be forgotten that ASEAN's original mandate had little to do with economics and that economic integration for ASEAN became important with the retreat of political tensions in the region and the rise of regionalism in the rest of the world in the 1970s (Saravanamuttu 2010). Today, this broad role is exemplified by scholars calling upon it to play a role to ensure the balance of power (Anwar 2018) or characterizing its family of institutions (like the ASEAN Regional Forum) as adopting a "layered approach to regionalism" (Yeo 2018). And while the implementation of the AEC is garnering considerable attention, ASEAN's stand, or lack thereof, on the South China Sea dispute is taking centre stage in current discussions.

The breadth of ASEAN's mandate poses a challenge to any writing on ASEAN. While it is possible to conceive a wide variety of issues to cover when assembling an edited volume, it is difficult to eventually obtain papers that can reflect the issues, arguments and evidence exhaustively. We cannot claim that we have built an elegant puzzle that addresses all important areas on the contemporary development of

ASEAN integration. Yet, we present here a set of incisive papers that offers a critical account of the issues that were raised at the Forty-Second Federation of ASEAN Economic Associations Conference, held in Kuala Lumpur in 2017.

The following paper, by Cheong and Yong on assessing ASEAN's relevance, highlights the growth of the organization's mandate over time that brought some successes but also inevitable failures. While successes could be attributed partially to the pragmatism and adaptability that the organization displayed, the policy space created by the departure of the United States together with China's preoccupation with its domestic reform also played a role. At the same time, an expanded mandate that led to the organization's overreach as well as the pre-eminence of national self-interest damaged the chances of success of some endeavours. The institutional informality upon which ASEAN was founded contributed both to its success and its failure. Taking a position at either extreme did not do justice to the organization. ASEAN remains relevant, the authors conclude, but not to the extent many of its proponents expected.

The third paper, by Lau and Yip investigates the link between fiscal deficits and economic growth in ASEAN countries in the pre- and post-Global Financial Crisis years, the presumption being that this link was affected by the Crisis. Using annual data from 2001 to 2015, they estimate the relationship between fiscal deficits and economic growth for ASEAN countries to be growth-deteriorating in the pre-Crisis period but growth-enhancing in the post-Crisis period. These results were found to be robust to different measures of economic growth. However, different factors influenced economic growth during the two phases; inflation was important pre-Crisis, but exchange rate and inflow of FDI were more important post-Crisis. The authors explain the differences by alluding to the fact that more capital was needed to stimulate economic growth post-Crisis, with more public spending leading to higher fiscal deficits. FDI also contributed capital and was, like fiscal deficits, growth-enhancing.

The fourth paper by Siti Muliana, Cheong and Zarinah visits the link between stock markets and economic growth, with the two financial crises, the Asian Financial Crisis of 1997–99 and the Global Financial Crisis of 2008 and beyond, impacting this link. Its objectives are to ascertain the impact of the two crises on the economies of the ASEAN-5 countries through impacts on their respective stock markets, and to estimate the transmission of impact from stock markets to real economic growth. Using rigorous quantitative techniques, their findings are more confirmatory than novel, strengthening the argument that the Asian Financial Crisis impacted Indonesia, Malaysia and Thailand more than the Philippines and Singapore, while the Global Financial Crisis had a limited impact on all five countries. Nevertheless, one benefit of their approach is to be able to quantify the magnitude of the impact. Also, through Impulse Response functions, the size and duration of impact of the stock market on economic growth were found to be pronounced for Malaysia and Thailand during the Asian Financial Crisis. Thus, stock market shocks could be predictors of impacts on the real economy, the authors conclude.

The fifth and final paper by Rubasundaram and Rasiah examines the state of e-governance among ASEAN countries with specific reference to corruption. Using both traditional measures and normalized indices prepared by the United Nations and the World Bank, this paper finds improvements in the information technology infrastructure of ASEAN economies. While it acknowledges the need to channel resources through the creation of rents towards productive economic activities, it argues that unproductive rentier activities must be curbed to stimulate structural change among ASEAN countries. Singapore stands out on measures of corruption and IT infrastructure, but performs poorly on press freedom. However, the paper argues for the need to introduce instruments to reward good conduct and penalize bad conduct alongside initiatives to promote civil society participation.

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NOTES

1. There was confrontation (*Konfrontasi*) between Indonesia and Malaysia, the Philippines' claim over Sabah, and the separation of Singapore from Malaysia in 1965 (Flores and Abad 2012). Also, some of the founding members are still facing Balkanization. Examples include: the independence of Timor Leste from Indonesia; Mindanao in the Philippines; Aceh, which managed to obtain devolution in Indonesia; and the Muslim crisis in Southern Thailand.
2. The CEPT was the primary mechanism for achieving the goals of the ASEAN Free Trade Area (AFTA) created in 1992. See ASEAN (1992).
3. As noted earlier, Mundell (1963) and Fleming (1962) offer an incisive account of how flexible exchange rates will clear trade imbalances.

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