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Realizing the ASEAN Economic Community

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Realizing the ASEAN Economic Community

A Comprehensive Assessment

Edited by
Michael G. Plummer and **Chia Siow Yue**



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Foreword

It has always been my cherished belief that if ASEAN succeeds, it will bring about positive consequences for ASEAN and the entire global community.

The ASEAN Economic Community is one of the three pillars of the envisaged ASEAN Community by 2015, which also comprises the ASEAN Political-Security Community and the ASEAN Socio-Cultural Community. Using the analogy of interlocking threads which hold a piece of fabric together, building an ASEAN Economic Community that provides economic stability and ensures continued economic growth will contribute towards peace, security and social progress, and thereby connect the region together.

ASEAN is weaving this piece of fabric based on the design of the ASEAN Charter and the Roadmap for an ASEAN Community (2009–2015). This book *Realizing the ASEAN Economic Community: A Comprehensive Assessment* attempts to communicate potentials, opportunities and challenges of community building to our people. It brings the vision of an ASEAN Economic Community to life by expressing it in concrete terms so that stakeholders such as the private sector and the consumers can identify with it and see the impacts that it can potentially make. More importantly, I hope that each stakeholder will assist in weaving this tapestry of the ASEAN Economic Community together.

For this, I am grateful to the US Agency for International Development and the US Department of State sponsored ASEAN-US Technical Assistance and Training Facility, and the various contributors who responded to the ASEAN Secretariat's request and made this book possible. This book reveals that the ASEAN Economic Community, if realized, will bring about an increase in economic welfare and real income in ASEAN and all member states will stand to benefit. While regional economic integration can create short-term adjustment costs, these costs should be more than offset by the benefits generated by well-targeted reforms in the longer term.

I hope that this book will strengthen our conviction that the ASEAN Economic Community will bring about a more prosperous, stable, competitive and equitable ASEAN. If ASEAN succeeds, it will be good for the region and the world. It is now the time to act expeditiously and credibly!

Surin Pitsuwan
Secretary-General of ASEAN

Executive Summary

The global economy and Asia in particular constantly produce challenges and opportunities for ASEAN and its member states. ASEAN economies must respond to the exigencies of the international marketplace; compete intensively for markets, investments and resources; adapt to the economic rise of China and India; and develop competitiveness and economic vigor sufficient to weather global economic shocks — a need underscored by the current global economic crisis. Greater economic cooperation and integration can help ASEAN Member States meet these challenges and seize opportunities as they emerge. In this regard, the ASEAN Economic Community (AEC) is a bold step in economic reform. As envisaged it is comprised of four parts:

1. A *single market and production base*, characterized by a free flow of goods, services, investment, and skilled labor, as well as a freer flow of capital.
2. A *competitive economic region*, characterized by sound competition policy, consumer protection, intellectual property rights protection, infrastructure development, sectoral competition in energy and mining, rationalized taxation, and e-commerce.
3. *Equitable economic development*, characterized by SME development and enhancement of the Initiative for ASEAN Integration.
4. *Integration into the global economy*, with ASEAN centrality and participation in global supply networks.

The creation of a single market and production base should allow ASEAN to benefit from efficiency and economies of scale in value-chain processes, while other aspects of the AEC will boost competitiveness, strengthen ASEAN's institutions, and improve the region's socioeconomic environment. ASEAN Member States intend to complete the AEC by 2015; meeting that deadline will require support at all levels and recognition that implementation will face opposition in some quarters. Securing support, assuaging stakeholders' concerns, and countering opposition, in turn, requires understanding the full implications of the AEC for ASEAN and ASEAN Member States.

ECONOMIC BENEFITS

Applying a computational general equilibrium (CGE) model under several scenarios, we estimate that ASEAN economic welfare should rise by 5.3 percent, or \$69 billion, relative to the baseline — more than six times the effect estimated for AFTA, even under conservative assumptions. We also estimate that the AEC will increase ASEAN real income significantly and that all member states will benefit from the AEC. Other estimated benefits include the following:

Expanded trade in goods. Our model shows that the AEC will expand ASEAN trade in goods, with exports outpacing imports in all but three manufacturing sectors. Many of these areas offer important opportunities for the region to join global production chains. Our estimates also confirm the value of keeping the AEC open, a position advocated in the AEC Blueprint: extending the AEC to include “+1” agreements with its East Asian neighbors increases the aggregate welfare benefits to ASEAN by two-thirds, and by an additional one-third if the United States and the EU are added.

Greater inflows of FDI. FDI will likely increase as barriers to production networks are removed and as policies in the ASEAN Comprehensive Investment Area (ACIA) are implemented. Production networks, in turn, should be particularly advantageous to SMEs throughout ASEAN and in the CLMV countries in particular. The AEC could increase FDI stocks 28 percent to 63 percent (\$117–\$264 billion relative to 2006 inward FDI stocks). Contribution to annual income growth could be (conservatively) on the order of 0.5–1.0 percent of GDP per annum. Over time, this effect could be considerable, given the potential of ASEAN Member States to expand in existing production value chains and enter new ones.

Rise in per capita GDP. To estimate the direct effects of behind-the-border measures and best practices spread by means of the AEC, we use “extreme bound analysis”. Our projections suggest that competition policy alone could raise per capita GDP by 26 percent to 38 percent in the resource-rich original group of ASEAN countries; this includes an increase of 8 percent to 14 percent due to foreign investment attracted by policy reform. These figures are on par with estimates of the economic impact of joining the EU.

Narrower development gaps. By creating opportunities for production networks and spreading best practices that boost productivity, the AEC should help the CLMV countries converge with the rest of ASEAN, a process that has already started. Productivity improvements will be greatest in the least-developed economies.

Flexible labor management that attracts investors. Allowing skilled workers to move about freely will make ASEAN attractive to foreign investors, encourage mutual recognition of professional qualifications, and engender regional cooperation among training institutes, universities, research institutions, and the like. Countries with shortages of skilled labor may benefit the most, and professionals and skilled workers will be able to seek better jobs and higher earnings.

Competitive consumer markets. Consumer markets will feature a cheaper and wider range of imported goods and services, greater domestic competition, and more extensive consumer protection. Institutional improvements under the AEC (e.g., in financial markets, infrastructure, and harmonization-related structures) should encourage growth in the private sector and make the public sector more efficient.

In sum, the net economic benefits of the AEC should be large, perhaps well beyond the 5.3 percent increase in welfare due to “AEC value added” derived through our conservative CGE model. Other likely gains not modeled include

- Lower cost of capital due to freer movements of capital and improved financial systems;
- Greater efficiency and boosts to GDP due to freer movement of skilled labor;
- Benefits from “ASEAN One Voice”, that is, ASEAN centrality in external relations and a stronger voice in regional and global affairs; and
- Greater macroeconomic stability due to implementation of conservative policies necessary to support the AEC.

STAKEHOLDER BENEFITS

ASEAN Member States. Member states are expected to experience employment growth, faster economic growth, larger inflows of FDI, better resource allocation with consequent improvement in productivity and competitiveness, scale economies and fragmented production. They will be able to extend their participation in production networks and global value chains, enjoy a larger regional market and more technological and human resources, and benefit from greater intraregional trade and investment, adoption of efficient international standards and best practices, and protection of intellectual property rights, which will attract technology-intensive FDI and R&D. Member states will be able to leverage the AEC to undertake sensitive domestic reforms, while faster growth and related efficiencies will raise tax revenue, offsetting any loss in tariff revenue. Through “one ASEAN voice,” member states will be more effective in international and regional forums; economic gains through ASEAN hub FTAs are estimated to be large.

CLMV countries. The CLMV countries stand to gain the most from the AEC through liberalization and reform that boosts efficiency and competitiveness. They will also benefit from greater access to capital, investment, technology, technical assistance, development experience, and best practices; greater participation in global production networks and value chains; and the influence of joint positions taken by ASEAN in regional and international negotiations.

Businesses, including SMEs. Businesses of all sizes will benefit from greater market access, lower input and transaction costs due to tariff and NTB elimination and improved services regulations, and better trade facilitation processes for customs, logistics, transportation, ICT, as well as rationalized rules of origin and product and technical standards.

Investors. Benefits will accrue from the right to invest, national treatment, improved investment protection and dispute settlement, and from more liberalized capital markets and financial services. Local investors will be able to form joint ventures with foreign investors and the smooth flow of skilled labor will create more management choices.

Professionals and labor. Unimpeded by artificial barriers, professionals and skilled workers will be able to seek better jobs and earnings. In expanding industries, services and firms will benefit from increased employment and higher wages.

Consumers. Consumers — stakeholders who tend to get little attention in ASEAN integration processes — will benefit from access to cheaper and wider range of imported goods and services, a more competitive domestic market environment, and consumer protection.

Global partners. The AEC's emphasis on open regionalism, with low trade and investment diversion, will engender a dynamic and economically resilient ASEAN able to contribute positively in international fora such as WTO, IMF, World Bank, and in regional forums such as APEC and ASEM.

In sum, the AEC has the potential to generate significant economic benefits for nearly all stakeholders in the region. The region will also gain political and macroeconomic stability and ASEAN can become a potent force in international fora. Nevertheless, as in the case of any policy change that leads to greater efficiency, there will be costs as well as benefits. For example, as less efficient sectors contract in favor of more efficient ones, jobs will be lost and workers may experience short-run unemployment. Clearly there is a need for appropriate policy responses at the national level to facilitate this structural change, hasten the restructuring process, and assist displaced workers through adjustment assistance, job-search help, and re-tooling programs.

Still, our results show that the gains of the AEC will be far greater than the losses, and the net benefits to all member states should be high. Realizing the potential of the AEC will require mustering the political support for effective implementation of the AEC Blueprint and beyond.

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