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## **INTRODUCTION**

### **The ASEAN Economic Community and Conflicting Domestic Interests**

Tham Siew Yean and Sanchita Basu Das

#### **1. INTRODUCTION**

The prospect of an ASEAN Economic Community (AEC) has progressively raised interest on the state of economic integration among members of the Association of Southeast Asian Nations (ASEAN). Although the Chairman’s Statement from the 26th ASEAN Summit (April 2015) indicated that the current rate of implementation of the 2007 AEC Blueprint (“the Blueprint”) goals stands at 90.5 per cent (ASEAN Secretariat 2015), there are numerous studies that question the use of a scorecard approach as a monitoring mechanism. These implementation scores do not necessarily capture the actual extent of economic integration in the region. For instance, recent business surveys show that although tariffs have been reduced or eliminated among ASEAN countries, non-tariff barriers are still prevalent (Kawai and Wignaraja 2011; Hu 2013). These include non-automatic licensing schemes, technical regulations, benchmarked standards, administrative costs, which are attached to the use of preferential measures,

and a lack of physical and institutional connectivity (ASEAN Secretariat and World Bank 2013). Similarly, ASEAN citizens can hardly attribute the rise in incomes or better job opportunities to the AEC initiatives (Chia 2011a). These caveats suggest that not all of the AEC targets can be achieved by the end of 2015. This deadline may well mark a milestone rather than the complete achievement of intended goals.

How then do we interpret the disparity between stated intentions, goals and targets of the AEC and its current state of achievements and implementation? The literature frequently attributes the lack of effective progress in ASEAN economic integration to a lack of political will. One possible explanation for the lack of political will is the fact that deep regional economic cooperation faces domestic opposition arising from various economic conflicts. For example, after the Treaty of Rome was signed, it took the European Economic Community nearly forty years to achieve its objective of a single market. The stalling Doha Development Agenda can also be attributed to domestic resistance and hostility from protectionist groups in participating economies that prevent member countries from achieving the required single undertaking rule. Likewise, for ASEAN, even though the AEC is a regional initiative, implementation is left to the individual member economies. Thus, regional cooperation might have to overcome domestic antagonism. In other words, while ASEAN's economic integration is a response by the region's respective governments to globalization, it may not be supported by some domestic interest groups.

This book surveys the developments in the past decade (2003–14) and argues that conflicting economic interests in each country is one of the possible reasons for the current fragmented state of community-building in the region. The objective of this introductory chapter is to explore this issue and to set the stage for the country studies featured in this publication. This chapter is organized as follows: the next section briefly synthesizes relevant literature on economic integration and contestations in trade policy formulation to provide an analytical framework for the featured country studies. Section 3 provides an account of the AEC and its progress since the Blueprint came into effect in 2008. Section 4 offers a preview of the country studies in this book and synthesizes the arguments on how conflicting domestic interests have affected the economic community building process in each of these countries. Finally, the last section summarizes the key findings of this chapter and provides

some policy suggestions for deepening economic integration in ASEAN beyond 2015.

## **2. THE THEORETICAL LITERATURE ON ECONOMIC INTEGRATION AND CONFLICTING DOMESTIC INTERESTS**

There are several definitions and interpretations of economic integration. Balassa (1961, p. 1) defines economic integration as “the abolition of discrimination within an area” and Kahnert et al. (1969) explain it as a process that is expected to progressively eliminate the discriminations that take place at national borders. Mutharika (1972), on the other hand, describes economic integration as the coordination of economic policies by states within a specific region so that they can meet the objectives of development. Subsequently, Panagariya (1998) argues that because economic integration may take many forms such as free trade agreements (FTAs), customs unions, common markets and economic unions, a more representative means of describing economic integration is to use the term preferential trade agreements (PTAs). A PTA is said to be an arrangement between two or more countries in which goods produced by those countries can be traded with fewer or lower barriers than goods produced by a country that is not a party to the arrangement (a non-member).

Mansfield and Milner (1999) argue that the theory of economic integration (or regionalism) has undergone four phases of evolution, each reflecting the policy concerns of its time. The first phase occurred during the second half of the nineteenth century and was largely concentrated in Europe. The second phase was during the inter-war period between World War I and II. The current economic integration is a post-World War II phenomenon spanning two phases: (i) from the late 1950s through the 1970s; and (ii) from the conclusion of the Cold War in the early 1990s, when there was a change in interstate power and security relations, to the present day.

The latest phase of economic integration from the early 1990s, also termed “new regionalism”, is said to have emerged primarily as a state-led project in the face of global competition. Grugel (2004, p. 604) describes the latest form of regional integration as a “route through which states mediate the range of economic and social pressures generated by globalization”. This is especially pertinent to smaller states that may lack the capacity to

manage the pressures of globalization at a national level. It is argued that this is the period when the states felt competition in attracting foreign capital to support production, forcing them to collaborate in order to attain a larger market space (Mittelman 2000).

Economic integration within ASEAN is also part of “new regionalism”. The ASEAN Free Trade Area (AFTA) was instituted in the early 1990s to provide new political purpose to the association/region after the end of the Cold War and the Cambodian crisis (Buszynski 1997). More than a decade later, when ASEAN decided to establish the AEC, several global forces had already pushed the ten small Southeast Asian economies to advance their economic integration process (Kawai 2005; Hew 2007). First, the 1997–98 Asian Financial Crisis (AFC) made the ASEAN countries realize the importance of a collective economic mechanism for regional stability and the prevention of future financial crises. Secondly, China’s accession to the World Trade Organization (WTO) and its rapid growth as an attractive market and production base also pressurized ASEAN countries to cooperate in order to offer economies of scale. Lastly, the proliferation of regional trading arrangements (RTAs) by European nations and the United States raised concerns among ASEAN governments to develop mechanisms to remain competitive and relevant in multilateral negotiations.

Therefore, ASEAN’s moves towards economic integration were motivated not just by economic reasons but also by political and strategic imperatives that pushed these ten economies to act coherently and manage their economic vulnerabilities. In light of this, ASEAN economic integration is often perceived as state-led or top-down integration (Sally 2006; Terada 2009). This form of state-led economic integration, with limited engagement of domestic stakeholders, can slow down the integration process in two ways. It can generate apathy from economic entities during the negotiation phase, and it may also generate domestic conflicts during implementation, as awareness of the implications of the commitments made sink into the minds of key stakeholders.

In international trade theory, economic conflicts are rooted in the distribution of gains and losses that emerge with trade liberalization. The two standard models used are the classic Heckscher-Ohlin (HO) and Ricardo-Viner models of trade. Factor endowments play a crucial role in determining patterns of trade in the Heckscher-Ohlin model. The related Stolper-Samuelson theorem in this model claims that returns to the owners of abundant resources will rise absolutely and disproportionately from

trade, hence, trade liberalization benefits the owners of abundant factors while owners of scarce factors will lose out. Abundant factors of a country engaged in trade will be used intensively in the production of goods whose prices will rise from increasing exports, thereby increasing their returns. Conversely, the returns to owners of scarce resources will fall absolutely and proportionately, since their factors will be used intensively in the production of goods whose prices will fall from increasing imports. The model thus predicts conflicts between capital and labour over trade policy as shown in Table 1.1 (Peamsilpakulchorn 2006; Keohane and Milner 1996).

The Ricardo-Viner model (or Specific Factors Model — SFM), is often deemed to be a short-run model, as it assumes an immobile factor that cannot be shifted across two sectors that are producing two different goods. A return to the immobile factor (usually assumed to be capital) is inevitably tied to the fortunes of the industry where it is employed. Thus factors specific to export-oriented industries will favour liberalization, whereas the reverse will hold true for the factor that is fixed in import-competing industries. The mobile factor (usually assumed to be labour) will shift between sectors until its return is equalized across the two sectors. Conflicting economic interests are therefore inevitable between the export-oriented or competitive sector (free traders) and import-oriented or uncompetitive sectors (protectionists) (Table 1.1). The impact on the real income of the mobile factor is ambiguous as it depends on the consumption patterns of the two goods. Hence, trade policy preferences will depend on their respective consumption patterns.

These traditional models are more applicable to inter-industry trade. However, intra-industry trade has become more important as evidenced by trade between similar countries or countries with similar endowments. New trade theory (NTT), developed by Krugman (1979), attempts to use economies of scale to explain the specialization of production in countries — done mainly to take advantage of increasing returns. Other assumptions that have been used in NTT include market imperfections, strategic behaviour and new growth theory. Many of the models based on market imperfections and strategic behaviour justify the use of protection to nurture firms or industries (Deraniyagala and Fine, n.d.). Although this strand in the literature dominated the discourse in the 1980s, it has since fallen out of favour due to difficulties in empirically verifying these theories. Furthermore, policy recommendations for protection based on these theories have been refuted by alternative arguments such as the

**TABLE 1.1**  
**Key Models of Interest Group Competition over Trade Policy**

	<i>Heckscher-Ohlin (HO) Model</i>	<i>Specific Factors Model (SFM)</i>	<i>Heterogeneous Firms Model</i>
Principal Actors	Factors of production	Industries or sectors	Firms which are heterogeneous
Mobility of Factors	Perfectly mobile across sectors	Immobile factors that are fixed in sectors (usually capital)	Mobile
Winners and Losers from Trade Liberalization	Winners: Abundant factors Losers: Scarce factors	Winners: Immobile factor in export-oriented sectors Losers: Immobile factor in import-competing sectors	Winners: Productive firms that export Losers: Less productive firms in import-competing industries
Conflicts	Capital vs. Labour	Export-oriented vs. import-oriented industries	Exporters vs. importers at the firm level

*Source:* Adapted and updated from Pearnisipakulchorn (2006).

predatory behaviour of governments. Hence, interventions aimed at remedying imperfect markets may lead to worse outcomes than those originally attributed to imperfect markets.

“New” trade theory shifts the unit of analysis from the country- or industry-level to the firm-level by assuming heterogeneity across firms rather than homogeneity, based on the Melitz model (Melitz 2003). In this class of models, different characteristics of firms have different implications on their trade policy preferences. For instance, productivity differences among firms can influence their respective trade policy preferences — highly productive firms are likely to be exporters while less productive firms are not. Thus in these models, less productive domestic firms lobby for higher tariffs whereas exporters favour liberalization to gain market access abroad. Another characteristic that can influence trade preferences is the size of a firm as larger firms tend to be pro-liberalization while smaller firms favour protection. Importantly, these firms may be operating in the same sector or industry and so political cleavages can occur within the same industry, unlike the class or sectoral cleavages analysed by the HO and SFM (Kim 2013). Therefore, regardless of whether the analysis is framed in terms of factors, sectors or firms, winners will press for liberalization and losers will resist, thereby setting the stage for economic conflicts from any liberalization efforts by an economy.

### **3. THE ASEAN ECONOMIC COMMUNITY**

In December 1997, ASEAN leaders adopted the ASEAN Vision 2020 in order to give the region long-term direction. This plan envisioned the formation of an ASEAN community by 2020, comprising three pillars: ASEAN Security Community (ASC),<sup>1</sup> AEC and ASEAN Socio-cultural Community (ASCC). At the 2003 ASEAN Summit in Bali, Indonesia, ASEAN leaders declared the establishment of an AEC by 2020.<sup>2</sup> The objective of the AEC is “to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in year 2020”. In January 2007, during the ASEAN Summit in Cebu, Philippines, the AEC deadline was brought forward by five years to the end of 2015 (ASEAN Secretariat 1997, 2003, 2007).

Subsequently, ASEAN achieved a major milestone at the November 2007 ASEAN Summit in Singapore when leaders embraced the 2007

AEC Blueprint, which lays out a roadmap for strengthening economic integration and realizing the AEC. The Blueprint is organized according to the AEC's four objectives: (i) a single market and production base; (ii) a highly competitive economic region; (iii) a region of equitable economic development; and (iv) a region that is fully integrated to the global economy, with 17 "core elements" and 176 "priority actions", to be undertaken within a strategic schedule of four implementation periods (2008–09; 2010–11; 2012–13; and 2014–15). The adoption of a blueprint showcased ASEAN members' willingness to approach the integration process with clearly defined goals and timelines. There seemed to be an eagerness among participating countries to achieve comprehensive and deeper economic integration and institutional development in the region.

Relevant ASEAN Ministers from each country as well as the ASEAN Secretariat were tasked with implementing the Blueprint and regularly reporting their progress to the Council of the AEC. This is when ASEAN came up with an AEC scorecard to track implementation. Since the Blueprint was adopted, the ASEAN Secretariat has released two official scorecards, one in 2010 and the other in 2012. The latter scorecard (published in March of 2012) states that ASEAN achieved 68.2 per cent of its targets for the 2008–11 period. The first scorecard (for 2008–09) reported an implementation rate of around 87.6 per cent of a total of 105 measures; the second scorecard (2010–11) reported a lower rate of 56.4 per cent of a total of 172 measures (ASEAN Secretariat 2010, 2012). Thereafter, official publication of scorecards was stopped, thereby generating concerns among the key stakeholders on the state of ASEAN integration. The only access to information is the Chairman's statement after the ASEAN Summits.

Indeed, ASEAN has achieved significant progress under its economic cooperation initiatives (Chia and Plummer 2013; Hill and Menon 2010; Basu Das 2012; ERIA 2012). The ASEAN-6 countries<sup>3</sup> have eliminated tariffs since 2010 and the CLMV countries (Cambodia, Laos, Myanmar and Vietnam) have lowered their intra-ASEAN tariffs from 7.3 per cent in 2000 to 1.8 per cent in 2013, as scheduled under ASEAN Trade in Goods Agreement (ATIGA)<sup>4</sup> (ASEAN Secretariat and World Bank 2013). The region is about to establish an ASEAN Single Window (ASW), which involves developing and interconnecting the National Single Windows (NSW) of ASEAN member countries.<sup>5</sup> The ASW will allow the ASEAN trading community to process the clearance of goods at the border through a one-time submission of data, which will then allow quick processing and decision-making. If it works, it is expected to save traders significant time and money.

In order to raise foreign direct investment (FDI) in the region, the ten nations put together the ASEAN Comprehensive Investment Agreement (ACIA) in April 2012, which consolidated provisions of the ASEAN Investment Area (AIA) and ASEAN Investment Guarantee Agreement (AIGA). ASEAN countries also allow flows of skilled professionals (Mode 4) to facilitate investment and the free flow of services. It provides for Mutual Recognition Arrangements (MRAs), wherein each country may recognize education and experience, and licences and certificates granted in another country. To date, ASEAN has concluded seven MRAs for: engineering and architecture; nursing; accountancy services; surveying services; and the medical and dental profession.

In order to benefit from the free flow of goods and services, ASEAN needs to reduce transportation and logistics costs between and within member countries. In 2010, ASEAN leaders adopted the Master Plan on ASEAN Connectivity, which is expected to link ASEAN countries by enhancing the development of physical infrastructure, institutional connectivity and people connectivity. The region has also established the ASEAN Infrastructure Fund (AIF) in collaboration with the Asian Development Bank (with a start-up capital of US\$485.2 million); the fund actively promotes a public-private partnership approach to implementing key infrastructure projects in the region. This initiative also helps with the region's competitiveness vis-à-vis the rest of the world.

To address development gaps, ASEAN embarked on a programme known as the Initiative of ASEAN Integration (IAI), wherein more developed ASEAN members are expected to support less developed members. ASEAN has strived to plug itself into the global economy and has played the role of a "bridge builder" among countries in the greater Asian context. The ten nations as a whole have signed free trade agreements with China, India, South Korea, Japan and Australia-New Zealand.<sup>6</sup>

Nevertheless, despite its achievements, it is also widely accepted that ASEAN is unlikely to fulfil all of its stipulated integration measures by the end of 2015, and even those that have been met are yet to be effective for key stakeholders (Chia 2011*b*; Severino 2011; Basu Das 2013; Chia and Plummer 2013). Although tariffs have been reduced or eliminated in the region, there has been very little progress in identifying and eliminating non-tariff measures (NTMs), which affect both imports<sup>7</sup> and exports,<sup>8</sup> hindering greater intra-regional trade (ASEAN Secretariat and World Bank 2013). With regard to the ASW, ASEAN countries may be challenged by a lack of coordination between agencies or a lack of appropriate human

resources. Currently, ASEAN suffers from a wide gap between members' logistics performance — while Singapore occupies the top position, Myanmar stands at the 129th spot out of 155 countries ranked in the 2012 World Bank Logistics Performance Index (LPI).<sup>9</sup>

ASEAN has also been negotiating its services sector liberalization agreement for the past fifteen years, but efforts thus far have resulted only in marginal liberalization (Nikomborirak and Jitdumrong 2013). It should be noted that the commitment under the services sector agreement does not aim for full integration as yet. For example, liberalization for mode 3 or commercial presence<sup>10</sup> envisions 70 per cent of ASEAN equity shares, while liberalization for mode 4 (movement of natural persons) is confined to the movement of professional workers only, with pre-agreed flexibilities and exceptions. Moreover, the MRAs governing the seven professions, except for engineering and architecture, do not contain any liberalization commitments. The MRAs mostly provide frameworks to promote the mobility of professionals between member states, on a voluntary basis. This generates flexibilities and allows member-states not to commit.

ASEAN's regional investment initiative, ACIA, came into effect in April 2012 and superseded the earlier agreement on investment, the ASEAN Investment Area (AIA). However, it has yet to be supplemented with supportive domestic investment policies and regulations, effectively rendering ASEAN into ten different markets rather than a single one (Bhaskaran 2013).

With regard to the association's integration with the global economy, despite the numerous ASEAN+1 FTA initiatives in the last decade, empirical evidence on the benefits accruing to ASEAN from these FTAs remains patchy and limited. Instead, there are concerns over the potential negative effects from these FTAs due to their complexity, inconsistent regulations, different rules of origin (ROOs) and the resulting "noodle bowl" effect (Kawai and Wignaraja 2011).

Hence, NTMs (with respect to the free flow of goods across ASEAN countries), high transaction costs (trade facilitation), entry barriers restricting the flow of services and FDI policies, concerns with ASEAN-led FTAs need to be addressed before ASEAN can be viewed as a single market and production base. This has also been noted by Severino and Menon (2013) who have stated that the year 2015 is not going to bring any significant changes to ASEAN; its nature, processes and member countries' interests will remain almost the same.

This book seeks to fill a gap in the literature on ASEAN by examining the impact of state-directed economic integration on domestic economic conflicts. Through selected country studies, this book also examines how these conflicts can affect a country's readiness to embrace the AEC. Specifically, it seeks to ascertain the type and nature of conflicts that have emerged in each of the countries studied. Identifying these conflicts is important for managing domestic consensus which, in turn, can pave the way for deeper economic integration in ASEAN. This is a very pertinent issue for ASEAN as it is standing at a critical juncture in 2015 whereby the credibility of its economic integration efforts is at stake. Member countries have to deliver on their past commitments whilst simultaneously aspiring for deeper cooperation in the future.

#### **4. THEMES IN THIS BOOK**

The rest of this introduction summarizes key findings on the causes and nature of domestic conflict from the regional and selected ASEAN country chapters in this book. The regional chapter by Severino and Thuzar provides a backdrop to the issues at hand by describing how ASEAN economic cooperation has been politically motivated from the very beginning. It further explores the political underpinnings of regional economic cooperation within ASEAN and the Asia-Pacific region. The authors note that the foreign policy of all sovereign states is driven by national interests, which in the case of the AEC is to enhance domestic competitiveness by creating a bigger economic space in the region for their firms. Nevertheless, there is misalignment in the domestic arena as this motivation encounters domestic contestations from businesses and sectors that are affected by the redistribution of power and resources due to the liberalization measures of the AEC. Similarly, regional consensus has to be negotiated, with flexibility given to less ready members through separate tracks. The other misalignment lies in the long-term goals of the AEC as envisaged by past leaders that had a longer term in office, while current leaders may be more short term in their thinking, due in part to the pressure from new media that also focusses more on short-term issues. The authors go on to assert that these misalignments will not only impede ASEAN's efforts of trying to achieve economic integration and the region's motto of "One Vision, One Identity, One Community" as enshrined in the ASEAN Charter, but they will also undermine regional solidarity. It may

result in uneven progress and may deliver on a two- or three-tier ASEAN, thereby dividing the region by winners and losers.

The nature of domestic contestations raised in the regional chapter is discussed in each of the chapters on the national economies in this book — Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam. It is observed that the conflicts range from macro-level policy-making to firm-level perception of winners and losers. The nature of domestic conflicts varies depending on the economic structure of the country, its stage of development and degree of openness to the global economy as well as its long-term development goals.

An important source of conflict in member countries is competing demand for scarce resources as the implementation of the AEC commitments requires considerable technical, financial as well as human resources. Yose Rizal Damuri's chapter on Indonesia points this out clearly in his discussion on the country's challenges in the implementation of facilitation and harmonization measures. It is reiterated in Vo Tri Thanh's study on Vietnam where it is explained that the country did not/could not expend resources to implement some aspects of the AEC, such as mutual recognition and services liberalization, because they are scarce. The bulk of government resources were used for the drafting of major laws or reforms that are considered to be cross-cutting issues related to the country's trade liberalization efforts. Hence, the domestic conflicts observed in this book may not be due to liberalization efforts under the AEC alone. This is because ASEAN member countries are not only pursuing economic liberalization under the auspices of the AEC, but are also involved in multiple trade agreements at the bilateral, regional and multilateral levels. There are also unilateral liberalization initiatives in some countries, as observed in the case of Malaysia and Singapore. These multiple commitments imply that scarce resources are stretched to the limit in some countries in terms of their abilities and capacities to meet their commitments in the Blueprint targets.

Nevertheless even when resources are available, poor coordination further compounds implementation issues in the face of complex bureaucracy and decentralized decision-making as discussed by Damuri in his chapter on Indonesia. For example, a single product may well be regulated by several ministries. Frequent reshuffling of ministerial positions further compounds the problem as it sometimes leads to discontinuities in the implementation process. To overcome these problems, a Presidential

directive is sometimes used to force ministerial cooperation, as illustrated in the case of investment facilitation.

State-led liberalization can also result in policy conflicts as illustrated in the Indonesian chapter when domestic policies favouring enhancing domestic competitiveness is prioritized over liberalization measures in general, including the AEC as these liberalization measures are deemed to facilitate import rather than exports. Thus inward-looking sentiments have led to less priority given for the implementation of AEC measures. This is amply illustrated in Damuri's example of the use of standards for protectionist intentions by promoting standards that differ from internationally accepted ones and Indonesia's less receptive response towards regulatory harmonization.

Policy conflicts also arise when domestic policies in a country are not aligned with these liberalization policies. Tham's country chapter on Malaysia highlights this. On the one hand, the services sector has been targeted as a new source of growth since the Third Industrial Master Plan (IMP3: 2006–20). Seven out of the twelve promoted sectors in the Tenth Malaysia Plan and the Economic Transformation Plan also belong to the services sector. However, this sector is relatively more protected by equity constraints as well as domestic regulations. In recognition of the need to liberalize this sector, the government has progressively initiated several unilateral liberalization initiatives. Nevertheless, Malaysia is cautious about making irreversible commitments under FTAs, including its commitments in the AEC. At the same time, the government is also liberalizing unilaterally resulting in a gap between commitments at the regional level and practise in the country as the latter is also guided by the unilateral liberalization efforts of the country. This cautious approach also affects the commitments as the horizontal measures that covers all sectors in Malaysia's commitments in services liberalization in ASEAN, also further strengthen the role of domestic regulations in the services sector, as illustrated in the author's case study of the wholesale and retail sector. The liberalization of services is also constrained by the extensive presence of government-linked companies (GLCs). These GLCs may be "sheltered" from liberalization by domestic regulations, which can serve as bureaucratic hurdles to foreign investment. Consequently, as in the case of the Philippines, liberalization commitments in the AEC can be thwarted by domestic policies that continue to protect domestic preferences and entities from the competitive forces of liberalization.

Austria's country study on the Philippines using the automotive sector as a case study clearly demonstrates that liberalization policies need to be accompanied by supportive domestic measures, such as improvements in administrative efficiencies as high administrative costs as well as high export and import costs can deter the FDI required for the country's industrial development. Another source of domestic conflict can be observed in the discord between trade and investment policies. Trade policies that prohibit the importation of second-hand motor vehicles and parts and components, except those made by returning residents and members of the diplomatic corps, are circumvented by the enactment of duty free zones and special economic zones that are used instead to import duty free second-hand vehicles and/or smuggle used vehicles. In contrast, these zones are not able to attract the needed investment into the automotive sector due to high production costs and the absence of a strong supplier base. The reduction of tariffs under AFTA has instead led to greater imports of vehicles and components and parts. The banking sector reveals further conflicting interests as local banks are also significant shareholders of the major auto multinationals in the country. Banks are therefore directing capital into auto loans instead of directing capital to low value-added production.

State-driven economic integration may also involve very limited consultation (or none at all) with relevant stakeholders, leading to a lack of domestic support in the implementation of the AEC measures. This is raised in country chapters such as Thailand and Vietnam. In particular, Vo's chapter on Vietnam highlights the importance of increasing stakeholder consultation, which has been carried out with respect to revisions of major laws in the country. The need for consultation in the redrafting of these laws has recently been formalized in 2008 even though some consultation processes were adopted before then. However, interestingly, the author also notes that the effectiveness of the consultation process appears to be limited for three main reasons. First, government consultation is confined mainly to traditional stakeholders such as government agencies, research and business communities while civil society and non-governmental organizations (NGOs) are seldom consulted except in some instances (the AEC and some major FTAs). Second, the output of the consultative process is not necessarily made public and this makes it difficult for the public to comment or to prepare adequately for the implementation of Vietnam's commitments. Given the low utilization rates of AFTA and other

ASEAN-related FTAs in the country as well as limited consultation, it is not surprising that the author notes that awareness of the AEC in Vietnam is limited and that there is a general lack of readiness or preparation for the country's effective participation in the AEC.

Conflicts may also emerge among stakeholders that may experience losses from the liberalization process such as the rural or working poor in Vietnam. Sineenat and Suthiphand's co-authored chapter on Thailand also shows that small farmers in the Thai agricultural sector are perceived to lose out as they lack the resources to compete with large businesses and multinationals in this sector. Moreover, both the Vietnam and Thailand country chapters show that small domestic enterprises may stand to lose from the liberalization measures in the Blueprint. In the case of Vietnam, this is attributed to their lack of capacity to understand the technicalities of liberalization and cooperation measures. In Thailand's case, the authors' examination of the logistics sector identifies size as an important factor in a firm's capacity to respond to the competitive challenges of the AEC-led liberalization measures. Small local logistics firms in Thailand are perceived to lose out as they do not have access to financial support and they cannot compete against the larger firms and multinationals in this sector in terms of developments in technology, management systems and marketing. Sineenat and Suthiphand therefore suggest that the main winners of the AEC will be the large exporters, large processing food companies and high-productivity farmers in the agricultural sector. Similarly, the potential winners of logistics liberalization in Thailand will be the large logistics companies, multinationals in the logistics business and other businesses that are customers of such services. Likewise, the Thai case study on the movement of natural persons (from the medical profession) suggests that hospitals that are engaged in medical tourism will be the main winners due to a shortage of medical personnel in the country. However, it is also feared that Thai medical staff may not be able to compete against inflows of medical personnel from other ASEAN countries who may have a greater advantage in terms of language abilities to communicate with international patients, including patients at border hospitals.

The country chapter on Singapore presents a unique situation. Given the absence of natural resources and an agricultural sector, the city-state has adopted the strategy of an open economy (with the rest of the world) since its independence. It has a high trade-to-GDP ratio of over 300 per cent and practises free trade in goods, except for the six tariff lines imposed on

alcoholic beverages. ASEAN economies are viewed as natural hinterlands to the city-state, and liberalization in ASEAN is viewed as a means to gain market access to this hinterland. Unlike almost all other ASEAN economies, where liberalizing engenders strong domestic political-economy responses, thereby slowing down the AEC implementation, this has not been the case for Singapore as domestic pressures hindering such implementation have been weak. Chia and Basu Das, in their chapter, note that this is partly due to the small size of the city-state and its long exposure to the competitive forces of globalization and regionalization. It can also be attributed to the high trust of the local citizens in their political and economic system, high employment rates, and a low incidence of poverty. Hence, as the authors illustrate with their case studies of the electronics and aviation sectors, there is very little domestic pressure in Singapore, particularly against the AEC's liberalization process. The pressure tends to come from Singapore's general approach of using non-protectionist measures in order to manage global competition. In such an environment, the government's policy response is to restructure its economic activities and continuously upgrade its competitiveness to meet liberalization challenges.

## **5. CONCLUSION: ASEAN BEYOND 2015**

ASEAN has come a long way since the inception of the ASEAN Free Trade Area (AFTA) in 1992. After liberalization initiatives in services trade and investment respectively through the ASEAN Framework of Services Agreements (AFAS) and the ASEAN Investment Area (AIA), ASEAN members have decided to adopt a more comprehensive form of economic integration, namely the ASEAN Economic Community (AEC) by the end of 2015. The member economies also adopted a blueprint that was binding in nature with clear action plans and timelines. However, as the deadline for establishing an AEC approaches, it is increasingly evident that ASEAN members will not be able to meet all its commitments as stipulated in the Blueprint. Many significant initiatives have to be carried forward to the next phase of ASEAN economic cooperation, beyond 2015.

However, the implementation of the AEC commitments since 2007 offers important insights and one such insight is the need for building domestic consensus. As can be seen from the country studies, most of the liberalization commitments under the AEC face domestic conflicts in terms of implementation, with the exception of Singapore. These conflicts may

occur due to the domestic policies of a country or the lack of domestic support in the absence of effective consultation among key stakeholders in an economy. There may be a lack of resources too as the AEC measures go well beyond tariff liberalization and impinge upon more complex issues such as trade and investment facilitation measures including the ASEAN Single Window, ASEAN Trade Repository, and Mutual Recognition Agreements.

Hence, as ASEAN stands at a juncture with respect to the nature of economic cooperation and liberalization beyond 2015, one needs to understand domestic conflicts and the different ways of handle them so as to achieve deeper integration. The country studies in this chapter present several ways of addressing this issue.

Domestic policies need to be aligned with liberalization commitments for greater policy coherence. This is especially emphasized in the Indonesian, Philippines and Malaysian country chapters. For example, the Indonesian country study highlights the need to harmonize domestic standards with internationally accepted ones instead of creating different national standards. For the Philippines, conflicts in trade and investment policies need to be overcome through the harmonization of investment incentives as well as centralizing investment promotion and facilitation. It also includes enhancing coherence across legislation, policies and programmes as well as improving the coordination of policies. In the case of Malaysia, domestic aspirations that are at odds with liberalization commitments need to be re-evaluated for liberalization measures to be effective. This includes a re-evaluation of the role of domestic regulations to assess whether they intentionally or unintentionally counter liberalization measures. The Vietnam chapter provides a positive recommendation of embedding action plans or programmes of liberalization, including the AEC commitments, within its socio-economic development plans to harmonize all its liberalization commitments, thereby simultaneously enhancing policy coherence.

Policy priorities need to be reviewed so that the implementation of the AEC commitments is prioritized in each country's agenda. Conflicting policy priorities can be seen in the case of Indonesia and Vietnam where the former prefers to prioritize domestic issues that can enhance the country's competitiveness and supply side capacity while the latter prioritizes domestic reforms that focus on broad laws such as Enterprise Law and Investment Law. Given the scarcity of resources, be it in terms of technical capabilities, financial or human resources, in both of these

countries, policy priorities will determine how these resources will be used for policy implementation.

The Thai and Vietnamese country chapters also emphasize broadening stakeholder consultation and deepening stakeholder engagement so that they are made aware of the implications of the country's commitments. This will enable stakeholders to take the necessary actions to prepare themselves for greater competition as well as to take advantage of the opportunities that come with greater regional economic integration. In this regard, stakeholder consultation may entail giving out more detailed and timely information as well as providing resources for the government to better engage with those affected by the integration process. It should be noted that poor countries may not necessarily have the human and financial resources for this purpose. Stakeholder consultation should be encouraged not at the ASEAN-level alone but at all levels of liberalization (multilateral and bilateral).

Another policy suggestion raised by the Thai and Vietnamese country chapters is the need to mitigate the negative impact of liberalization measures on domestic stakeholders, such as the poor and small domestic producers, by initiating assistance programmes and/or enhancing social safety nets. In this regard, the Philippines chapter also suggests the use of government assistance for improving the capabilities of those negatively affected to help them compete and withstand competition from cheaper imports. The Thai country chapter warns that there is a need to monitor such assistance funds so that they will be as effective as was intended. Other measures include the consolidation of small firms to increase their size, especially when size is a constraint on their ability to compete (such as the logistics sector). The Philippines chapter also discusses the need to find niche products and markets as a means of facilitating the country's ability to compete in the automobile sector. In terms of workers' mobility, the Thai country chapter recommends skills development for local workers to help them work in a cross-cultural environment and to compete with foreign medical workers from other countries. Thus, preparing domestic producers and workers for the AEC is an important step for allowing a country to fully implement and access the benefits of the AEC's liberalization measures.

An important lesson can also be learnt from the Singapore experience in terms of a country's readiness to embrace liberalization. Given increasing globalization, protectionist measures are no longer a viable policy response.

ASEAN member countries have to consider ways and means to restructure or upgrade key strategic sectors so that they may benefit from greater liberalization. As the authors of the Singapore chapter demonstrate, the electronics sector in the city-state has undergone dramatic restructuring in response to changing comparative cost advantages and the emergence of competitive facilities in other ASEAN countries and in China. The Singapore policy response has been to fully support liberalizing trade in goods within the AEC while concurrently assisting affected businesses and workers; helping them upgrade and move resources into more competitive sectors and activities. Likewise, with respect to the aviation sector, and although it is facing significant competitive pressures, the government's policy response has been to develop and upgrade Changi airport into a more competitive air hub, and to enable Singapore Airlines (SIA) and its affiliates to be more competitive.

The policy suggestions from the chapters in this book, therefore, highlight the importance of stakeholder consultation as a means of increasing information flows for facilitating successful buy in and cooperation among implementing agencies and enhancing the capacity of the domestic sector to compete. The aforementioned are critical for promoting domestic consensus. The use of limited resources for the implementation of the AEC commitments can only be achieved through prioritizing these commitments in each country. Coordinating domestic policies, integrating actions undertaken by various implementing agencies and embedding these aims within a country's development strategies are also crucial for reducing policy conflicts as ASEAN member countries move towards deeper economic integration beyond 2015.

## Notes

1. This pillar is now known as the ASEAN Political and Security Community (APSC).
2. This is known as the Declaration of ASEAN Concord II or the Bali Concord II.
3. The ASEAN-6 countries are Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand.
4. ATIGA consolidated and streamlined all provisions in the Common Effective Preferential Tariff (CEPT) scheme under the ASEAN Free Trade Area (AFTA) and other protocols related to trade in goods into one single legal instrument. It entered into force in 2010 and superseded CEPT-AFTA.
5. Being a single point of information for trade and clearance of goods at the

- border, it allows for more simplified trade processes, with fewer delays and lower costs.
6. The FTA between Australia and New Zealand is known as the Closer Economic Relation (CER).
  7. Import restrictions have been adopted to meet the objectives of public health, infant industry protection or consumer health.
  8. Most ASEAN member countries require export licences (except for the Philippines) or impose export taxes (except for Brunei, the Philippines and Singapore) for selected products, including goods within intra-ASEAN trade.
  9. The LPI measures border control efficiency (customs), infrastructure quality, ease of arranging competitively priced shipments, competence of logistics services, ability to track and trace consignments, timeliness in shipments.
  10. The 1994 General Agreement on Trade in Services (GATS) has identified four modes of supply: cross-border trade (Mode 1: when neither producer nor consumer move, but the service itself is traded, e.g. business or financial services provided by mail or telephone); consumption abroad (Mode 2: consumption abroad occurs when consumers move to the location of the service, such as tourism); commercial presence (Mode 3: when producers enter a host country via a long-term presence); and movement of suppliers (Mode 4: when producers enter a host country via a shorter-term movement of people, for example, a foreign IT-expert travelling to a site to implement a technology plan).

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