

# A SEAN Economic Community 2015 & Beyond

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## Introduction: ASEAN & Japan

The Association of Southeast Asian Nations (ASEAN) is one of the most important economic partners of Japan. With a population of more than 600 million and GDP of US\$2 trillion (roughly 200 trillion yen), ASEAN accounts for 15% of Japan's trade (exports and imports, totaling 19.8 trillion yen) — smaller than China but larger than the United States, the Middle East, and the European Union, as of 2011. ASEAN is also one of the largest destinations of Japanese foreign direct investments (FDI) with a share of 17% (1.5 trillion yen) in 2011, larger than China. When looking at the stock base data of Japanese FDI, ASEAN is seen to have 11.5% (8.6 trillion yen), following the US, EU and Latin America, but exceeding China (as of 2011).

On top of its strong economic relationship with Japan, ASEAN is increasingly attracting business attention. The Japan Bank for International Cooperation (JBIC) annually surveys Japanese manufacturing firms and publishes the prospective top 20 mid-term investment destinations for them. The latest report in 2013 reveals that Japanese business is giving increasing attention to ASEAN. As many as nine members are ranked among the top 20. Indonesia is ranked top, surpassing even China which had kept the top position for more than 20 years until 2012. Following Indonesia are Thailand (3rd), Vietnam (5th), Myanmar (8th), the Philippines (11th), Malaysia (12th), Singapore (16th), Cambodia (17th) and Laos (20th). While Brunei is not in the list, this simply reflects the fact that large investments have been already made in the oil and gas industries.

This positive perception of ASEAN by Japanese firms comes from several factors. It is maintaining high growth and improving the macroeconomic environment. The middle-income population is expanding rapidly. It is also important to note here that not only large populous countries but also smaller and less-developed countries have started to attract FDI. The improved links between member states, in addition to the economic environment in each one, enable these countries to participate in and benefit from the regional production network.

All these changes are backed up by regional efforts towards the realization of the ASEAN Economic Community (AEC) in 2015. The AEC covers broad areas of economic policy, certainly more than just trade. ASEAN has already made significant achievements. At the same time, however, there remain substantive tasks to do before Dec. 31, 2015. Equally interesting is the fact that ASEAN has just started discussions on its next plan, called the “ASEAN Economic

Community Post 2015 Vision”. How far could ASEAN progress by then? What comes next after 2015? This short piece discusses the state of AEC 2015 and the future possibility for an AEC beyond 2015.

## AEC Blueprint 2007

At the ninth ASEAN Summit in October 2003, leaders envisioned the realization of an ASEAN Community by 2020, consisting of an ASEAN Security Community (later changed to “ASEAN Political Security Community”), the AEC, and an ASEAN Socio-Cultural Community (ASCC). The target year was subsequently brought forward from 2020 to 2015.

The AEC is the most important and probably the most advanced pillar of the three communities. Details of AEC programs are explained in the AEC Blueprint endorsed at the 13th ASEAN Summit in November 2007. The blueprint presented four pillars, namely, (1) Single Market and Production Base, (2) Competitive Economic Region, (3) Equitable Economic Development and (4) Integration into the Global Economy. Each pillar has two to seven sub-pillars as illustrated in *Table 1*.

The first pillar deals with typical free flow agendas. It covers goods, services, investment, capital and skilled labor. The major components are trade in goods, trade in services and investment, for each of which ASEAN has already signed regional agreements and is in the process of implementation.

The second pillar deals with national regulations: intellectual property, competition policy, consumer protection and taxation. While most of these tend to be cooperative in nature, ASEAN has also agreed on specific individual goals such as the introduction of a national competition policy by 2015 in all of the member states. This pillar also covers infrastructure for which another comprehensive plan, the Master Plan on ASEAN Connectivity (MPAC), was adopted in 2010.

The third pillar addresses the equity issue within borders (through small and medium enterprise (SME) development) and outside borders (through development of the CLMV countries — Cambodia, Laos, Myanmar and Vietnam), while the last pillar interestingly talks about ASEAN's integration with external parties. As the ASEAN economies rely on external major economies as export destinations and import sources, it is prudent for the 10 members to jointly deal with external partners in terms of economic diplomacy mainly via free trade agreements (FTAs).

Most AEC measures benefit both ASEAN's indigenous firms and

TABLE 1

## Four pillars of ASEAN Economic Community

Pillar 1: Single Market & Production Base	Pillar 2: Competitive Economic Region	Pillar 3: Equitable Economic Development	Pillar 4: Integration into the Global Economy
<ul style="list-style-type: none"> <li>• Free flow of goods</li> <li>• Free flow of services</li> <li>• Free flow of investment</li> <li>• Free flow of capital</li> <li>• Free flow of skilled labor</li> <li>• Priority Integration Sectors</li> <li>• Food, agriculture and forestry</li> </ul>	<ul style="list-style-type: none"> <li>• Competition policy</li> <li>• Consumer protection</li> <li>• Intellectual property rights</li> <li>• Infrastructure development</li> <li>• Taxation</li> <li>• E-commerce</li> </ul>	<ul style="list-style-type: none"> <li>• SME development</li> <li>• Initiative for ASEAN Integration (IAI)</li> </ul>	<ul style="list-style-type: none"> <li>• Coherent approach towards external economic relations</li> <li>• Enhanced participation in global supply networks</li> </ul>

Source: AEC Blueprint (2007)

foreign firms. To cite some examples, low tariffs apply to products made in the ASEAN region no matter who owns the capital of producers. Trade facilitation programs equally benefit all the operators who export or import in the region. Services liberalization (mode 3) and investment liberalization, although discriminatory in international legal schemes, are often extended non-discriminatory to all investors in the actual national implementation. Legal infrastructure such as intellectual property rights and competition policy, typically does not give preferential treatment to regional groupings. Needless to say, FTAs with external parties will benefit business in the covered countries. Thus, the AEC measures are quite relevant and favorable to non-ASEAN businesses as well.

### Achievements & Progress of AEC 2015

The most authoritative analysis of AEC implementation is the book called *AEC Scorecard* produced by the ASEAN Secretariat. The AEC Blueprint classifies the action items into four phases: I (2008-09), II (2010-11), III (2012-13), and IV (2014-15). The Secretariat produces biannual reports and provides overall achievement scores of the AEC. As of this writing, the latest report is the AEC Scorecard published in the spring of 2012 which covers action items for 2008-11. The overall assessment of the first two phases was 67.5% (Pillar 1: 65.9%, Pillar 2: 67.9%, Pillar 3: 66.7%, and Pillar 4: 85.7%). The latest available score as of October 2013 is 79.7% which means that 279 measures have already been implemented. It is important to note, though, that these data only assess the implementation ratio of the 2008-2011 policy measures. These four years represent only the first half of the AEC Blueprint's planned schedule. As one can easily imagine, the latter half (2012-2015) involves policy measures that

are even tougher to implement. Thus, one should carefully look at the next AEC Scorecard result which is expected to cover the years 2008-2013 (Phases I to III).

Another key official document assessing AEC progress is the *AEC Midterm Review* by the Economic Research Institute for ASEAN and East Asia (ERIA). This study was commissioned by the ASEAN Economic Council (ministerial level) and was reported to the Council in 2012. The study reviews all the major AEC measures in terms of the implementation ratio, actual outcomes of such policy implementation acquired through

intensive interviews and surveys, and potential economic impacts of key policy measures. While the full report is a classified document for the use of ASEAN member states and the Secretariat, an Executive Summary is made available.

The most evident achievement in the AEC is tariff elimination. By 2010, the ASEAN-6 countries (that is, Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) had eliminated tariffs on more than 99% of products. In the same year, the CLMV countries had reduced tariffs to a maximum of 5% for more than 98% of tariff lines, and committed to eliminate tariffs at the latest by 2018. On the other hand, elimination of non-tariff barriers (NTBs) faces a more serious challenge. The ASEAN Trade in Goods Agreement (ATIGA) requires all the member states to eliminate NTBs within a certain period of time. The process starts with self-declaration of NTBs by each member, followed by reviews from other members, and then the elimination process. Most member states, however, did not report the existence of NTBs as all the measures are "WTO consistent non-tariff measures (NTMs)" rather than NTBs. ASEAN is now shifting its focus to NTMs including, but not limited to, technical standards and regulations. The reduction of NTMs will be a priority area in the post-2015 AEC.

Trade facilitation is another important aspect of free flow of goods. The flagship project is called the ASEAN Single Window (ASW) which enables electronic exchange of trade-related documents across the ASEAN countries. The idea is to establish National Single Windows (NSWs) in each of the member states, which are electronic systems covering a wide variety of trade-related documents and procedures, and then to connect the NSWs regionally. Five member states have already operationalized their respective NSWs and two more will do so by 2015 (the exceptions being Cambodia, Laos and

Myanmar which are currently working on simplifying their customs procedures). ASEAN has already finished a test-run operation of the ASW in which two documents were successfully exchanged among members. Full operationalization of NSWs in Cambodia, Laos and Myanmar and expansion of document coverage in the ASW will be critical elements in the post-2015 era.

On top of the NSW-ASW project, ASEAN has also delivered some significant results in trade facilitation. It has set up and implemented regional common tariff classification at the eight-digit level (ASEAN Harmonized Tariff Nomenclature) as well as liberalized the rules of origin in 2008 which are now adopted in the ASEAN-Australia-New Zealand FTA, ASEAN-Japan FTA, and ASEAN-South Korea FTA.

In terms of services liberalization, ASEAN leaders set ambitious and numerical targets in the AEC Blueprint. The most prominent target is to allow for 70% ASEAN foreign equity across all the sectors by 2015 (with limited exceptions). ASEAN applies a gradual approach to reach this target by signing packages every other year. The most recent package is the eighth package called the ASEAN Framework Agreement on Services (AFAS) adopted in 2012. The good news is that this AFAS package has achieved a higher level of liberalization than any other FTA that ASEAN has signed. Yet ASEAN is aiming even higher by 2015. The ninth package is under negotiation, albeit with some delay. The full achievement of services liberalization targets, however, will require yet another package.

The ASEAN Comprehensive Investment Agreement (ACIA), meanwhile, which became effective in 2012, is the main tool for investment liberalization, protection, facilitation and promotion in ASEAN. ACIA covers non-services investment such as manufacturing, fishery, forestry and mining. Unlike services liberalization, though, the AEC Blueprint did not set numerical targets for non-services investment. ACIA instead categorizes the remaining limitations (which are stated in the reservation lists of each country) into two categories and has recently started a peer review exercise towards the reduction of limitations.

The AEC Blueprint covers “free flow of skilled labor” instead of “free flow of labor”. Thus, unskilled labor is outside the scope of the AEC. The main instrument to realize this is mutual recognition arrangements (MRAs) of professional qualifications, covering eight professions (e.g., architects, engineers and nursing services). While the regional schemes are developed especially for architects and engineers, regionally recognized professions still need to apply for visas and work permits. In addition, ASEAN has introduced the ASEAN Agreement on Movement of Natural Persons which lays the foundation for future liberalization of skilled labor flow within the region.

Pillar 2 has also started to deliver substantive outcomes. For intellectual property, ASEAN has committed to accede to major international agreements, especially those of global filing systems. Eight member states, for example, already participate in the Patent

Cooperation Treaty. Competition policy is another important aspect. To facilitate the 2015 target to have a national competition policy in all member states, ASEAN has created the ASEAN Regional Guidelines on Competition Policy. The document is a reference for member states in developing their national competition legislation. While not binding in nature, it has the potential to converge the substantive and procedural provisions of national legislations over time. As such, ASEAN has started to touch on national regulation issues without forming a customs union, unlike the typical economic integration theory of Hungarian economist Bela Balassa.

Another important achievement is the so-called ASEAN+1 FTAs. As the AEC Scorecard shows, Pillar 4 has marked the highest score, which is due to the successful conclusion of five FTAs with ASEAN's major trading partners. Furthermore, ASEAN is taking the lead in consolidating the existing FTAs into one FTA covering the whole of East Asia — the Regional Comprehensive Economic Partnership (RCEP), which is expected to be concluded by the end of 2015.

To sum up, efforts toward creating the AEC have already achieved a lot, and ASEAN will probably bring forth additional fruits in the next one and a half years. The world will not change overnight, of course, on New Year's Day of 2016. Nonetheless, AEC 2015 will represent a body of achievements that ASEAN has made since 2007. On the other hand, major tasks in some areas will remain and ASEAN should continue working on them. In this regard, ASEAN Secretary-General H. E. Le Luong Minh stated that “The building of the ASEAN community will not be an event but an evolving process. Once we've got the ASEAN community in place, the process of ASEAN integration will continue.” At the same time, ASEAN should step up its integration efforts once the initial stage has ended by 2015. Post-2015 should be about much more than the tasks remaining from AEC 2015.

## Official Discussions about AEC Post-2015 Vision

The first official discussions on the Post-2015 AEC took place in 2011 under the strong leadership of Indonesia. At the 18th Summit, the leaders stated as follows: “While initiatives and actions are taken to ensure the realization of ASEAN integration by 2015, we should not lose sight of what we envision of ASEAN beyond 2015.” They went on to mention the initial idea of “ASEAN beyond 2015” as being “competitive, fairly equal, inclusive, green, sustainable and resilient”. At the same time, the leaders suggested adopting multi-track and multi-speed approaches to deepening economic integration among ASEAN members and their dialogue partners.

The official discussions were expedited and reached full scale in 2013. At the 22nd ASEAN Summit (April 2013), the leaders instructed the ASEAN Community Councils to initiate work on a post-2015 vision. Indonesian President Susilo Bambang Yudoyono made proposals at the meeting to introduce ambitious goals such as

“doubling GDP and halving poverty by 2030”. In October 2013, the 23rd ASEAN Summit issued the Bandar Seri Begawan Declaration on the ASEAN Community’s Post-2015 Vision. In the Declaration, the leaders instructed the ASEAN Community Councils to expedite work on developing the post-2015 vision, and recommended central elements of such vision for the endorsement of the ASEAN Summit in 2014. ASEAN plans to announce its post-2015 vision at the 26th ASEAN Summit which will be held in autumn 2015 under the chairmanship of Malaysia.

For the AEC, a deputy ministers’ meeting known as the High-Level Task Force for ASEAN’s Economic Integration (HLTF-EI) is taking the lead, inviting input from relevant ministerial processes and sectoral bodies. A senior official-level working group was formed under the HLTF in early 2014 which frequently meets to propose the key elements of the post-2015 vision at the next ASEAN Economic Ministers’ meeting in August 2014. ASEAN actively collects input from academia as well. During the stage of the AEC Blueprint drafting before 2007, ASEAN fully utilized the input from a consulting firm and several academic institutions. Similarly, the HLTF-EI officially asked two groups — the ERIA and a coalition of two Singaporean institutes — for studies and recommendations. Unfortunately, these documents are not publicly available at the time of writing. Instead, the following section discusses some issues that are critical for the post-2015 debate.

## Some Issues on AEC Post-2015

### i. Does ASEAN go for a customs union?

One frequently asked question regarding the AEC post-2015 is whether or not ASEAN is going to establish a customs union. As already discussed, the most important achievement of ASEAN’s economic integration initiatives is tariff elimination. In 2010, the ASEAN-6 countries eliminated duties for more than 99% of tariff lines. The CLMV countries are following the same path and are expected to complete tariff elimination by 2018 to the same degree as the ASEAN-6 members. Thus, a customs union may sound a natural next step for economic integration.

There are four major challenges, however, for ASEAN to move towards a customs union. First, the common external tariff rate will probably be somewhere near the current average tariff rate which is 9.7% as of 2013. Thus, Singapore needs to raise its tariff rates *vis-à-vis* non-ASEAN countries, which would be a fundamental policy change for the city state.

Second, in a customs union, the tariff revenues will belong to the community rather than to the 10 sovereign states. As sovereignty has been a critical institutional element of ASEAN since the beginning (1967), the establishment of a supra-national institution will take a long time.

Third, some smaller states rely on tariffs as an important source of government revenue. For example, tariffs and related revenues had more than a 20% share of total government revenue in 2010. If tariff revenues go to the ASEAN Community, Cambodia should consider alternative revenue sources. Fourth, tariffs function as a protective tool in many countries as sensitive sectors differ widely from country to country.

This does not mean that ASEAN will stop its efforts towards “free flow of goods”. Rather, there remains a lot of work that it will need to complete, with tariff elimination for the CLMV countries by 2018 being the most important action agenda. In addition, ASEAN should intensify its efforts to eliminate/reduce non-tariff measures (including cooperation on standards and conformance) and facilitate trade (including, but more than, the ASW).

### ii. Does the EU provide a model for ASEAN?

Another popular FAQ regarding the AEC post-2015 is whether or not ASEAN should be modeled on the EU. The simple answer is no. As former ASEAN Secretary-General Surin Pitsuwan said: “While the European Union is an inspiration for ASEAN, it is not a model for the region’s body. Development and ASEAN integration will proceed at their own pace.”

The EU and ASEAN are quite different. First of all, ASEAN involves large differences in the level of economic development in the regional grouping. At the same time, because generally the economic development level is lower in ASEAN than in Europe, the governments have only limited capacity, which is critical in some policy areas (e.g., standards). While European economic integration started in 1951 with the agreement to establish the European Coal and Steel Community, ASEAN’s economic integration initiatives were substantiated only in 1992 with the ASEAN Free Trade Area. Thus, ASEAN lags *behind* the EU by some 40 years.

These different environments have led ASEAN to its own economic integration model. As a result, while the European Commission and some EU members intensively support the AEC efforts, the current AEC programs have major differences from the EU model. ASEAN is not a customs union. So far, it has not discussed the possibility of a single currency. Unlike the EU, the free movement of ordinary people, even skilled labor, is limited in ASEAN in terms of the regional framework (while in reality there is significant movement). ASEAN’s competition policy is cooperative. Regional competition regulation in the EU style is many steps away. European institutions are much more sophisticated with enforcement mandates at the Commission and strong judicial functions. ASEAN made a significant step in 2008 with the effectuation of the ASEAN Charter which provides the basic legal infrastructure. However, sovereignty remains a key principle and as such ASEAN is cautious about having a supra-national institutional arrangement.

ASEAN may look far behind European-style integration if one takes a linear economic integration evolution perspective. But on the other hand, one should understand that ASEAN is creating a new integration model — a regional production network — that can be extended to other parts of the developing world. The regional production network is the economic reality behind ASEAN's recent developments. As mentioned above, the CLMV countries have started to join and benefit from this regional production network. Such development can be attributed to a series of national, sub-regional and regional efforts. At the same time, the existence of borders is a key enabling factor as evidenced by the rapid economic development of border areas. If movement of people is totally liberalized, and if the prices are equalized across the region, the less (or least) developed economies may not have a chance to catch up. Thus, while the EU inspires ASEAN, the best model for ASEAN should be crafted by ASEAN itself.

### iii. Inclusiveness, innovation, sustainability & resiliency

There is an emerging consensus that the AEC Post-2015 Vision should cover the issues of inclusiveness, innovation, sustainability and resiliency. In addition to integration agendas and competitiveness, the 18th ASEAN Summit listed equality, inclusiveness, greenness, sustainability and resiliency as other key elements. Major academic reports on the future of the AEC such as ERIA's *Jakarta Framework: Moving AEC Forward into 2015 and Beyond* in 2011 and the Asian Development Bank Institute's *ASEAN 2030* also emphasize these elements, with some different nuances.

Inclusiveness is increasingly capturing politicians' attention. Leaders committed to further enhance the third pillar of the AEC Blueprint by first adopting the ASEAN Framework for Equitable Economic Development at the 19th Summit in November 2011. They recognized that other pillars such as a single market and production base contribute to inclusiveness. At the same time, however, they acknowledged that there is a lot of room for intensifying efforts on equitable development. The Declaration touched on a wide range of potential policy areas such as human development, national and regional connectivity, and coherent macroeconomic cooperation.

Second, with many member states reaching the middle-income level or even upper middle-income level, ASEAN is facing the challenge of further upgrading their economic structure. The AEC Blueprint covers intellectual property but most other innovation-related projects such as education, and science and technology are handled under the ASCC. ASEAN therefore recognizes the significance of connecting the ASCC agenda for the purpose of economic development.

The third element is environmental sustainability. Once again, environmental issues are under the umbrella of the ASCC agenda while the ministerial process on energy is considered as a part of the

AEC. Environmental constraints will pose challenges and create opportunities for economic development (e.g., green products). The AEC should pay greater attention to the sustainability issue.

Finally, resiliency is recognized broadly as an important element for economic development. The wording is broadly understood to cover such issues as (a) security of food, energy and resources, (b) disaster management, and (c) social safety nets, as ASEAN experienced a surge in natural resource prices in 2007-2008 and disasters such as the Thai floods in 2011 in the course of AEC implementation. These policies should therefore be considered from an AEC perspective as well.

## Japan's Engagement with the AEC

Japanese businesses have been the largest contributor to ASEAN economic integration. It was a Japanese company which proposed the Brand-to-Brand Complementation scheme in the mid-1980s, thereby providing a breakthrough in ASEAN's economic integration. Japanese manufacturing subsidiaries in ASEAN have significantly improved their efficiency by fully utilizing the AFTA and other schemes, and hence created significant employment in the region.

At the same time, Japanese businesses have been the largest beneficiaries of ASEAN integration. On top of that, ASEAN is becoming even more important for them as a *market* rather than a *factory*. Thus, the level of achievement of the AEC 2015 and the new vision for post-2015 will definitely be relevant to Japan.

Japan should therefore proactively engage with the AEC, and has a variety of channels for doing so. Diplomatically, Japan has one of the largest permanent missions to ASEAN. Prime Minister Shinzo Abe has set up and strengthened the Japan-ASEAN Integration Fund to support ASEAN. The Federation of Japan Chambers of Commerce in ASEAN regularly meets with the ASEAN secretary-general and other top officials to solve practical issues on the ground.

On the other hand, ASEAN needs support from Japan for the next step of economic development. Japanese businesses continue to make large investments in the region, and Japan is also an important market for ASEAN products. Moreover, Japan has much experience in addressing the policy challenges that lie ahead for ASEAN.

Thus, Japan and ASEAN should collaborate in the development and implementation of the AEC 2015 and beyond to maximize the benefits and minimize the costs of endeavors for both. **JS**

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