

# Opinions

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## ASEAN Economic Community: A New Chapter in ASEAN Economic Integration



OH Yoon Ah

Ph.D., Research Fellow, Head of Southeast Asia and Oceania Team  
Korea Institute for International Economic Policy 

ASEAN (The Association of Southeast Asian Nations) regional integration will reach a new milestone this year, with the official launch of the ASEAN Economic Community (AEC) on December 31. AEC seeks to create a single production base and a single market for the ten ASEAN member states with freer movement of goods, services, capital, investment and skilled labor. It will generate economies of scale and create an economic environment with a level playing field, less protectionism and greater competition in the region. AEC is part of a broader ASEAN regional integration program which includes the ASEAN Political-Security Community and the ASEAN Socio-Cultural Community.

According to one estimate, AEC will increase regional GDP by 1-2 percentage points, and the integration process will accelerate structural shifts in member states.

When considered as a single unit, ASEAN is the seventh largest economy in the world, accounting for 3.23% of global GDP. Its economy is larger than major emerging economies such as Russia, India and South Africa. Its 625 million population offers the third largest labor force and market in the world, only smaller than those of China and India. Its real GDP growth has been fairly steady, at an average 5.1% for 2000-2013. The growing middle class and young demographic structure of ASEAN countries provide a promising consumer market.

AEC has four pillars: 1) single market and production base, 2) competitive economic region, 3) equitable economic development, and 4) integration with the global economy. Creating a single market and production base is the most important objective of all. Free (or freer) flow of goods, services, investment, capital and skilled labor is being promoted to this end. AEC has designated 12 priority integration sectors including agriculture, textile, automotive products, electronic goods, health care, tourism, e-ASEAN, air transport, and logistics. ASEAN has been largely successful in reducing tariffs for trade in goods, but progress has been slow in the elimination of non-tariff barriers (NTBs). From customs requirements to safety regulations, NTBs not only vary in types but also differ substantially from one country to another. With almost zero-tariffs within the region, tackling NTBs will be the main challenge for AEC. Service liberalization is likely to begin with air transport, e-ASEAN, health care, and tourism. To facilitate intra-ASEAN trade in services, Mutual recognition arrangements (MRAs) have been proposed in seven professional services: engineering, nursing, architecture, surveying service, medical and dental profession, accountancy. Yet making substantial progress in service liberalization will be difficult because it requires harmonizing regulatory frameworks in member states. For investment, ASEAN Comprehensive Investment Agreement (ACIA) will integrate existing agreements on FDI, including ASEAN Investment Area (AIA) and ASEAN Investment Guarantee Agreement (IGA). ACIA will focus more on investment protection and investment facilitation compared to previous agreements, and it needs to put the ASEAN Dispute Settlement Mechanism (ADSM) back on track which has seen little progress over the years.

The main goal of AEC is to create a positive business environment out of ASEAN—a modest one compared to the EU-style establishment of a supranational entity—by achieving economies of scale and enhancing the competitiveness of the region. The critical reason why ASEAN members actively pursue AEC is that ASEAN has been overshadowed by recent

surge of China and India in the global economy. ASEAN used to be a more attractive destination, but its FDI share has been declining over time. ASEAN also saw a need to develop greater external leverage as a single bloc in the midst of the proliferation of regional integration initiatives. Finally, it also helped that, due to the economic development of the region, countries in Southeast Asia started to see neighboring countries as potential markets not just as competitors.

Nonetheless, AEC faces three momentous, if not insurmountable, challenges. First, AEC tries to integrate a highly heterogeneous region in economic, political, cultural terms. Development gaps and other intra-regional heterogeneity in ASEAN are well-known, and need not be repeated here. Suffice to say that they severely limit ASEAN's ability to develop a common policy. Second, ASEAN has high levels of economic dependence on economies outside ASEAN for its trade and FDI. Intra-ASEAN trade and investment has been low albeit improving slightly. The share of intra-regional trade has never exceeded 25 percent, and less than 20 percent of ASEAN's FDI inflows come from within the region. Its external dependence also means that ASEAN is pursuing a dual strategy through AEC. ASEAN seeks to achieve intra-regional integration while simultaneously pursuing deeper economic engagement with external partners by integrating itself more firmly with global value chains. Last but not least, the lack of political leadership makes an already difficult task more challenging. Indonesia is naturally expected to assume leadership of ASEAN integration given its economic size and population, yet it has not been able or willing to provide sufficient initiatives for integration.

In sum, AEC is work in progress and should be understood as such. As stated in almost every serious discussion on AEC, December 31, 2015 is a milestone, not a deadline. The fact that ASEAN economic integration has made progress so far is impressive despite the unfavorable initial conditions described above. Despite the fact that AEC is the most important event that has happened to ASEAN economies in recent years, public and business awareness remain extremely low, inside and outside the region. ASEAN governments and partner countries need to engage businesses for better awareness and preparedness. The private sector needs to be pro-active and actively solicit information, looking out for changes in regulatory framework, incentives for FDI, and an overall business environment reshaped by AEC.