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Huge Challenges Await AEC 2025

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EXECUTIVE SUMMARY

- ASEAN economic cooperation has now advanced from AEC 2015 to AEC 2025.
- Though similar in objective on delivering deeper integration and a cohesive region, the AEC 2025 blueprint complements AEC 2015 economic integration measures with some new ones. It continues to emphasize liberalization and facilitation while adding new issues to the mix, such as sustainable development, good governance, innovation and the strengthening of the role of the private sector and other stakeholders.
- AEC 2025 has five pillars instead of four in AEC 2015, and distinctly highlights the “people” to mitigate complaints that ASEAN economic integration so far has minimal input from the people, including the private sector.
- Challenges that AEC 2025 faces include an increasing number of non-tariff barriers (NTBs) and the prioritizing by governments of investments in national infrastructure over trade liberalization; lack of alignment of national and regional interests; difficulties in implementation at the domestic level; and uncertainties in the global economy.
- Going forward, ASEAN countries will need to strengthen industries in their individual economies, educate their bureaucrats comprehensively on AEC measures, place equal importance to building national infrastructure and economic cooperation, and devote more financial and human resources to regional integration.

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INTRODUCTION

ASEAN entered a new phase of economic integration when, in late 2015, the ten Southeast Asian Leaders announced the establishment of an ASEAN Community (AC) of 630 million people and laid down the vision for the next ten years. Of the three pillars of this Community², the ASEAN Economic Community (AEC) offers economies of scale to attract foreign investors into the region and to enable manufacturers in the small countries to participate in Global Value Chains (GVCs)³. Ability to meet these twin objectives is primarily dependent on three factors – elimination of border tariffs, reduction of beyond-the-border impediments, defined as the non-tariff barriers (NTBs), and reduction of administrative costs. While ASEAN member countries have been successful in reducing border tariffs, the other two objectives have remained as ongoing efforts. Hence, the earlier blueprint, AEC 2015, has advanced to AEC 2025 to deepen the scope of the blueprint.

This paper looks at the AEC 2025 blueprint and compares it to AEC 2015. It briefly discusses issues that have remained as work-in-progress and looks at challenges that makes further economic integration difficult.

AEC 2025 vs AEC 2015

AEC 2025 retains the key vision of the earlier blueprint. The goal is still the creation of a deeply integrated and cohesive ASEAN that can deliver inclusive economic growth. Alongside the earlier focus on trade and investment initiatives for businesses, the new blueprint emphasizes the use of science and technology and the development of human resources, good governance and connectivity.

There are three main differences between AEC 2025 and AEC 2015 (Annex 1). First, the new blueprint has five pillars instead of four. *Enhanced Connectivity and Sectoral Cooperation* is added and it mostly includes elements of pillar 1 and pillar 2 from the old blueprint. For example, transport and ICT of the second pillar of AEC 2015 is now under the new pillar of connectivity. Moreover, the priority integration sector of AEC 2015 in pillar 1 is renamed as sectoral cooperation (involving tourism, healthcare and minerals) and now sorts under pillar 3. Second, AEC 2025 describes headings and sub-headings as necessary implementations rather than as aspirational phrases. For example, the aspirational goal of *Single market and production base* in AEC 2015 is pronounced as *Highly integrated and cohesive economy* in AEC 2025. The sub-heading of *Free flow of goods* now reads as *Trade in goods*, minimizing risks of misunderstanding among common people. Third, the fourth pillar of the new blueprint mentions “people” exclusively, responding to the longstanding complaint that AEC had developed in top-down style and with minimal involvement from below. The pillar also mentions the business community and civil society organizations as key stakeholders in ASEAN’s integration.

² The other two pillars of ASEAN Community are ASEAN Political-Security Community (APSC) and ASEAN Socio-cultural Community (ASCC).

³ A global value chain describes the full range of activities undertaken to bring a product or service from conception to end use, cutting across international borders.

Hence, looking at the differences, one may infer that ASEAN policymakers have learnt from their experience. With AEC 2025, the policy makers have tried to clear most of the misunderstanding created by the aspirational phrases in the AEC 2015. They have identified new elements of economic growth for member countries over the next ten years. These include a new emphasis on innovation and productivity, using digital technology to enhance trade and investment, strengthening the role of small enterprises and promoting good governance.

AEC 2025 also recognizes more clearly that regional economic integration is a dynamic process and that the member countries and the global environment are constantly evolving. It is in this context AEC is termed as a work-in-progress. The section below briefly outlines the achievements made under AEC 2015 and notes the outstanding measures to be undertaken in the years ahead.

AEC 2015: A WORK IN PROGRESS

According to an ASEAN Secretariat monitoring report, AEC 2015 has achieved 92.7 per cent—469 of 506—of its prioritized measures.^{4,5} This is a significant achievement. But despite that, the business community remains ambivalent about regional integration. Populations that feared that the end of 2015 would see their countries adversely affected by immigration soon realized that AEC 2015 brought neither ill effects—nor benefits—to their daily life.

The reason for this derives from the fact that AEC 2015 was not designed to deliver a single-market production base. While its regional mechanism to liberalise merchandise trade, and simplify customs and investment procedures offered economies of scale, initiatives such as the liberalization of investments and the movement of skilled labour were stated on a selective basis. Competition policy and intellectual property rights were issues included simply to nurture discussion, while leaving them as national matters. Connectivity is no doubt an essential condition for integration, but ASEAN has only limited financial and technical resources to see it substantially enhanced anytime soon.

Many AEC 2015 measures were considered fully implemented only in terms of a comprehensive regional document having been delivered, rather than by virtue of any

⁴ ASEAN Secretariat (2015), ASEAN Economic Community 2015: Progress and Key Achievements, Jakarta: The ASEAN Secretariat

⁵ The same report also mentions that for the total AEC measures of 611, implementation rate stands at 79.5 per cent as of end-October 2015. The difference in the implementation rate, i.e. 92.7 and 79.5 per cent, derives from the total number of measures. Initially, in the 2007 AEC blueprint, there were only 316 measures. Over time, the list of measures expanded to 611 in order to take into account new global challenges and to break down the stipulated blueprint measures into more tangible and measurable actions. However, in 2012, high-impact activities were prioritized to deliver AEC by 2015. In addition, in early 2015, another list of 54 high priority measures was added, which were said to be a ‘must have’ for implementation before the end of 2015. It was the 54 high priority measures and the ones implemented since 2008 that formed a focused base of 506 AEC measures

physical implementation. Hence, more needs to be done to achieve ASEAN integration than what might appear to be the case.

Annex 2 depicts some selected areas where ASEAN has managed to deliver on its commitments and also what remains as challenges for the future. For example, under *Trade in goods*, the ASEAN-6 members have eliminated intra-regional trade tariffs, with 99.2 per cent of tariff lines at 0 per cent. The corresponding figure for CLMV countries stands at 90.86 per cent.⁶ Other than that, to lower trade cost, the ASEAN countries have simplified the Rules of Origin (ROO), enacted the self-certification scheme, established a national single window and national trade repository (NTR) for a subset of ASEAN countries, and signed the legal framework for implementing the ASEAN Single Window⁷. However, non-tariff barriers (NTBs) continue to prevail in the region. These can be in the form of national standards, the imposition of the local content requirement rule at the national level, export or import taxes, non-automatic licenses and many others. Hence, whatever positive effect has been achieved by tariff elimination or measures like self-certification scheme is negated by the prevalence of these NTBs. Many NTBs are created to manage domestic political settings and to postpone trade liberalization, thereby referring economic integration to being an ongoing process.

CHALLENGES GROW

Although the distance travelled by ASEAN so far has been modest, the region faces immense challenges where its process of economic integration is concerned.

First, there is growing nationalism in some ASEAN countries. Indonesia, the biggest ASEAN member, continues to impose NTBs to protect its industries. For example, the country has recently imposed a local content requirement for smartphone manufacturers in order to lower imports and nurture local design and manufacturing capacity. It had earlier imposed regulatory requirements, i.e. registration with Ministry of Trade by batik-patterned fabric importers in order to protect the domestic batik industry. Other countries have realized that the availability of soft and hard infrastructure at the national level is a prerequisite if they are to benefit from regional economic integration. Hence, their priority has shifted from implementing AEC liberalization measures to building national infrastructure. Since developing infrastructure entails a huge amount of financial resources, countries prefer to be in the good books of China who has recently been enticing the smaller

⁶ ASEAN-6 countries refer to Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. CLMV countries refer to Cambodia, Laos, Myanmar and Vietnam. CLMV countries have a longer timeline till 2018 to fully eliminate their intra-regional trade tariffs.

⁷ Under the Self-certification scheme, traders and manufacturers are given the primary responsibility for origin certification. This was devised to encourage traders to avail themselves of the trade preferences provided under the ASEAN Trade in Goods Agreement (ATIGA). The ASEAN Single Window (ASW) creates a single point of entry for all trade-related documents to speed up customs clearance, thereby reducing transaction time and costs. The trade repository is meant to keep all trade-related information in one place. This includes MFN tariff rates, ATIGA preferential tariff, other ASEAN FTAs, ROO, non-tariff measures, national trade and customs laws and rules.

developing countries of ASEAN with infrastructure development schemes such as One Belt, One Road (OBOR) and the Asian Infrastructure Investment Bank (AIIB).

Second, countries are willing to be part of ASEAN as long as it serves their national interest. This could be politics or it could be economics. Being very different from each other, ASEAN member countries have different expectations from AEC. While the AEC serves as a big hinterland for an open economy like Singapore, for a small underdeveloped country like Laos or Cambodia, its usefulness lies more in attracting FDI. At the same time, Indonesia, the biggest member, is mindful that other ASEAN members do not benefit at its expense under AEC. In this tussle of varied national interests, regional economic cooperation takes a low priority, thereby leading to implementation gaps. For example, in total FDI flows into the region, Singapore currently attracts a lion's share of 51 per cent, whereas Cambodia, Laos and Myanmar are able to attract only 1-2 per cent. For the less developed ASEAN members, this demotivates them from dedicating more resources to regional integration.

ASEAN members also have different strategic interests when it comes to industries. This influences not only their negotiation positions, but also the pace of implementation of policies. While countries like Thailand and Indonesia promote the automotive industry and implement AEC measures related to that industry in a relatively timely manner, countries like Myanmar or Brunei are more interested in prioritizing resource-based industries. This weakens the development of an integrated market for the auto sector in the region.

Moreover, many ASEAN countries function with close clientelistic ties between businesses and politicians⁸. Understandably, domestic-market oriented firms fear regional integration the structural change it might bring to the national economy. Should these firms have close relations to power holders; demands for domestic regulations to circumvent the reforms required for regional integration will be strong. This is seen in the case of many of the ASEAN's Mutual Recognition Agreements (MRAs) for professionals, where permission for employment of foreigners is subject to domestic rules and regulations.

These kinds of differences in national interest and political culture often trump regional initiatives and delay the process of integration significantly.

Third, ASEAN countries have met most of the easier commitments they made under AEC. Implementing the rest requires a confluence of factors. Apart from political willingness at all levels of the bureaucracy, implementation of these relatively difficult measures need robust organization and substantial human and financial resources. Most ASEAN countries do not have these. Although the political commitment at the highest level may be strong, it gets diluted as the implementation process moves down the levels of bureaucracy. Many times, this is due to lack of alignment of interest between political leaders and bureaucrats; the adamant nature of implementing officers; and the capacity to understand the

⁸ While businessmen provide funding for the election campaign of a politician, they either get nominated in return as a party member who can influence policy decision in areas of their interests, or they can receive state facilities, such as export and import license and state bank loans. (Jayasuriya, K and Rosser, A (2006). 'Pathways from the Crisis: Politics and Reform in South-East Asia since 1997' in Garry Rodan, Kevin Hewison and Richard Robison (Ed) *The Political Economy of South-East Asia: Markets, power and contestation*, Oxford University Press).

technicalities of AEC measures. Budgetary deficiencies also delay implementation substantially.

Lastly, efforts to deepen economic integration in ASEAN is being taken at a time when global economic growth is modest, at around 3.2 per cent, almost the same as last year. Meanwhile, risks for much weaker global growth remain. There are several uncertainties, including the slowdown and rebalancing in China; the decline in oil prices which has distributive consequences across sectors and countries; and a general slowdown in investment and trade⁹. There are also non-economic factors present in the form of geopolitical tensions adding to the uncertainties. In addition, Britain's recent decision to leave the European Union raises doubts about the future of regional integration in general. Together, these make the ASEAN member countries more concerned about economic stability in their own country and less prone to devote resources to regional integration.

CONCLUSION

ASEAN economic integration has advanced from AEC 2015 to AEC 2025, with many of the tasks under the earlier blueprint yet to be implemented. Despite the promise in the new blueprint to deliver comprehensive sustainable growth and development, the pace of AEC implementation is going to slow down significantly in the face of increasing challenges. While some AEC 2025 commitments will be met, most will simply pave the way for future actions, and the rest will remain too sensitive to be adopted at the national level in the stipulated time-frame.

What else needs doing to continue ASEAN's economic integration? First, ASEAN countries need to strengthen their domestic industries by raising productivity. While protectionism and low productivity help in earning revenue and saving jobs in the short term, they undermine industrial development over time and hold back potential improvements in living standards. Second, infrastructure is crucial for economic development. It has to be undertaken simultaneously with economic integration. ASEAN countries need to work out an appropriate public-private-partnership programme to build domestic infrastructure. The development of economic corridors can be a useful infrastructure model for consideration¹⁰.

Third, educating bureaucrats on the AEC will help align their interests with their political leaders. Lastly, ASEAN countries need to allocate more resources to regional integration and put regional initiatives at par with their domestic agenda. This will strengthen ASEAN in face of the common external challenges.

⁹ IMF, World Economic Outlook, April 2016

¹⁰ Economic corridors are a combination of infrastructure networks and economic activities in a geographical space. Corridors can be built both within and between countries.

Annex 1: Characteristics and Elements of AEC 2025 and AEC 2015 Blueprints

AEC 2025	AEC 2015
I. A Highly Integrated and Cohesive Economy	I. Single Market and Production Base
Trade in Goods	Free flow of goods
Trade in Services	Free flow of services
Investment Environment	Free flow of investment
Financial Integration, Financial Inclusion and Financial stability	Free flow of capital
Facilitating Movement of Skilled Labour and Business Visitors	Free flow of skilled labour
Enhancing Participation in Global Value Chains	Priority integration sectors
	Food, agriculture and forestry
II. A Competitive, Innovative and Dynamic ASEAN	II. Competitive Economic Region
Effective Competition Policy	Competition policy
Consumer Protection	Consumer protection
Strengthening Intellectual Property Rights Cooperation	Intellectual property rights (IPR)
Productivity-driven Growth, Innovation, Research and Development and Technology Commercialization	Infrastructure development (included Transportation and ICT)
Taxation Cooperation	Taxation
Sustainable Economic Development	E-Commerce
III. Enhanced Connectivity and Sectoral Cooperation	
Transport	
Information and Communication Technology	
E-Commerce	
Energy	
Food, Agriculture, Forestry	
Tourism, Healthcare, Minerals and Science and technology	
IV. A Resilient, Inclusive, People-Oriented and People-Centred ASEAN	III. Equitable Economic Development
Strengthening the role of Micro, Small and Medium Enterprises (MSME)	SME Development
Narrowing the Development Gap (includes IAI)	Initiative for ASEAN Integration (IAI)
Strengthening the role of the private sector	
Public-Private-Partnership	
Contribution of stakeholders on REI	
V. A Global ASEAN	IV. Integration into the Global Economy
(covering ASEAN+1 FTAs and RCEP)	Coherent approach towards external economic relations
	Enhanced participation in global supply networks

Source: ASEAN Secretariat (2015) and ASEAN Secretariat (2008)¹¹

¹¹ ASEAN Secretariat (2015), ASEAN 2025: Forging Ahead Together, Jakarta: The ASEAN Secretariat; ASEAN Secretariat (2008), ASEAN Economic Community Blueprint, Jakarta: The ASEAN Secretariat

Annex 2: AEC is a Work-in-Progress

Completed Tasks	Remaining tasks and challenges
<u>Trade in Goods</u>	
Tariff has been eliminated/ reduced; ROO has been simplified; started with self-certification scheme	Non-tariff barriers prevail.
A subset of ASEAN Countries have set up their NSW and have established their NTR	NSW suffers from lack of coordination mechanism between agencies, lack of human resource and technical capabilities, NTR is also not fully effective.
Harmonization of technical standards for 3 sectors have been signed– Electronics and electrical equip, cosmetics and pharma products (auto discussion is in advanced stage)	Implementation in national economies is incomplete and uneven. (Foodstuff and building and construction materials are a work in progress).
<u>Trade in services</u>	
Mode 1 (cross-border supply, where neither the provider nor the consumer moves) and Mode 2 (implies consumption abroad, like tourism) has been met	Mode 3 (commercial presence i.e. FDI liberalization) not been met
Mode 4 (movement of people) has been signed for 8 professionals – engineering, nursing, architect, surveying, accountancy, medical, dental and tourism professionals.	Different ways of cooperation across the professionals, National rules governing the professional remains.
<u>Free Flow of Investment</u>	
ASEAN Comprehensive Investment Agreement (ACIA), describing liberalisation, protection, promotion and facilitation, has been put in place	Liberalization is difficult to achieve.
Promotion is done - linked investment agencies' website, developed and disseminated investment publications and conducted roadshows and public seminars	Investment facilitation (transparency, regulations, infrastructure, institutions) has to be carried out in national economies
<u>Competition Policy and IPR</u>	
ASEAN Expert Group on competition has been set up, ASEAN Regional Guidelines on Competition Policy and the Handbook on Competition Policy and Laws in ASEAN for Businesses were written.	none of these talk of a region-wide standardized competition policy and leaves it as a national subject
ASEAN IPR Action Plan 2011-15 has been adopted.	There is no mention of a region-wide IPR regime. It is a national subject.
<u>Infrastructure Development</u>	
ASEAN Highway Network, Singapore-Kunming Railway Line, ASEAN Open Skies Policy, ICT Development have been identified.	All these are multi-year projects and none of them are completed yet. Many challenges remain, including securing financial resources.
<u>Narrowing Development Gap</u>	

Initiative of ASEAN Integration (IAI) finished two phases – 2002-08 & 2009-15	Lack of coordination efforts among donor agencies, did not completely fit into CLMV needs; new issues of climate change etc not addressed.
<u>SME Development</u>	
Strategic Action Plan for the ASEAN SME Development (2010-15) - ASEAN Benchmark for SME Credit Rating Methodology, web-based SME Service Centre, ASEAN Common Curriculum for Entrepreneurship, an ASEAN SME Policy Index.	Earlier issues remain: limited access to finance and technology, severe competition from MNCs and SMEs of other countries, weak human resource, lack of awareness of AEC initiatives.
<u>Integration into the Global Economy</u>	
ASEAN has signed five FTAs with Australia-New Zealand, China, India, Japan and South Korea.	All the five FTAs are different from each other and there is a need to put them under a common framework. Negotiation of the Regional Comprehensive Economic Partnership (RCEP) agreement is ongoing since 2013, with many challenges unresolved.

Source: author's compilation

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