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### **Towards ASEAN Economic Community 2025!**

*By Sanchita Basu Das*

#### EXECUTIVE SUMMARY

- ASEAN will require a new economic community vision beyond 2015, given the changing nature of the region's political economic landscape.
  - Such a new vision, suggestively called AEC 2025, needs to be based on ASEAN's own strengths and weaknesses. The present slowdown in the US and the EU markets, growing competition from China and possibly India will convince ASEAN to hasten economic cooperation among its members. This will offer opportunities for foreign investors.
  - AEC 2025 should aim for an economically desirable, politically acceptable and developmentally achievable region. It should aspire to increase productivity, enhance connectivity, liberalize services sector, give due attention to the PPP model of regional investment, deepen financial sector cooperation and seek new FTA partners.
  - The new vision needs to address cross-cutting issues such as good governance, stronger institutions, and a transparent economic scorecard. In delivering on its promises by 2025, ASEAN should be able to build up on its credibility and maintain its centrality in the FTA structure of the Asia-Pacific in the long run.
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## INTRODUCTION

As ASEAN moves closer to 2015 in its bid to build an economic community as envisioned in its first Blueprint, there will be increasing discussions about the organisation's possibilities beyond that crucial year. Should ASEAN have a second regional economic vision that builds on its earlier efforts? The answer is a definitive 'yes'. This is because building a community is an ongoing process in which new agreements and declarations will be needed in light of global political and economic changes. Moreover, ASEAN countries are at different developmental stages, meaning that the deepening of economic cooperation will require a judicious but steady approach.

What can a new AEC Vision look like? To start answering this question, we have to focus on ASEAN's strengths and weaknesses. At the same time, opportunities and threats after 2015 need to be recognized.

## STRENGTHS AND WEAKNESS

ASEAN is a growing market of 600 million people with a combined GDP of US\$2.1 trillion. The region's robust economic growth is primarily driven by its demographic dividend fuelling domestic consumption, as well as investments in productive sectors. These factors suggest confidence among international investors in ASEAN's economic prospects. The countries' strengths range from natural resource-based production to highly capital-intensive industries (electronics, textiles, automotive sector). Collectively, the region has a highly competitive production base, stemming from relatively good infrastructure and low wage skilled workers. Investors also benefit from ASEAN's geographic location between India (South Asia) and China and Japan (East Asia) which, in turn, helps it to participate in the Asian production network.

Consistently strong emphasis on education over the years has put ASEAN ahead of many emerging markets in meeting the needs of international businesses. Progressive liberalization policies contribute to maintaining ASEAN's global competitiveness and this has made the region an ideal location for international firms to do business. Following the implementation of AFTA (ASEAN Free Trade Area), which has seen ASEAN-6<sup>1</sup> countries applying zero tariffs on 99 per cent of goods and the CLMV<sup>2</sup> countries trading 98.6 per cent of goods at 0-5 per cent of tariff rate, ASEAN is now moving towards establishing the ASEAN Economic Community (AEC) by 2015. This promotes ASEAN not only as an integrated market but also as a single investment destination. The ASEAN Charter has also conferred legal personality upon the regional grouping.

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*1 Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand*

*2 Cambodia, Laos, Myanmar and Vietnam*

However, while the preferred ‘ASEAN Way’ has allowed for maximum flexibility, taking into account changing domestic circumstances, the diversity of ASEAN members has made it harder for the organisation to reach consensus. Some countries in ASEAN are also at risk of falling into the ‘middle income trap’. This represents a stage where a country is stuck at a relatively comfortable per capita income (US\$7,500 to US\$10,000) but cannot seem to take the next big step to become a developed nation.

Another ASEAN weakness is the slow progress in domestic reforms and this has resulted in a lack of incentive for the private sector to fully utilise regional preferential measures. Despite ASEAN FTA being in place for the past two decades, the overall utilisation rate is around 22 per cent for the region. In addition, many ASEAN countries (Singapore, Thailand, Malaysia, Indonesia and the Philippines) have a rapidly ageing society. The region also suffers from a weak institutional structure.

**Table 1: GDP Growth Forecast (in %) of ASEAN vs Rest of the World (2013-2018)**

<b>ASEAN</b>	<b>World</b>	<b>The US</b>	<b>The EU</b>	<b>Japan</b>	<b>China</b>	<b>India</b>
5.8	4.2	3.0	1.4	1.3	8.4	6.6

*Source: author’s compilation; IMF World Economic Outlook, April 2013*

Regional economic integration in ASEAN is gathering momentum, creating potential for a seamless competitive market of more than US\$2.0 trillion. ASEAN is reaching out to establish FTAs with China, Japan, India, South Korea, and Australia-New Zealand, re-emphasizing its position as a major production base in the world market. It is also committed to deepening intra-regional economic integration with participation from the private sector.

Over the years, with its development programmes, ASEAN members have achieved substantial poverty reduction and the formation of a middle-income population. ASEAN is registering rapid growth in services and knowledge-intensive industries such as tourism, hospitality, education and biotechnology industries. The growing demand for infrastructure is opening new opportunities of investment and employment in the region. Given rapidly rising health care costs in many ASEAN countries due to ageing population, opportunities exist for mutually beneficial cooperation in health care activities, and in generic drugs. The rising affluence of the workforce has strong implications on demand for life-style consumer goods and financial products.

However, ASEAN is still dependent on external demand and continues to be vulnerable to protectionist policies despite various efforts aimed at increasing domestic demand. Any slowdown in the US, the EU or the China market has significant implications in terms of GDP and employment growth for the ASEAN economies. The export competition posed by Chinese goods in the important markets of the United States and Japan is a major concern for regional policy makers. The region also faces some competition from India in the sphere of business process outsourcing, as both are popular destinations for lower-skilled jobs. The simmering tensions in the South China Sea, a critical trade route, also threaten trade and stability in the region. Additionally, bird flu or a SARS outbreak poses a big risk to public health in the region. ASEAN also faces new challenges like global warming and climate change and these have implications for food security in the region.

**Figure 1: Consolidated Analysis of ASEAN's Strengths and Weaknesses**

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>• Market of 600 mn people</li> <li>• Availability of natural resource</li> <li>• Integrated production base/networks</li> <li>• Geographical proximity to other regions</li> <li>• Low wages and relatively high human development indicators</li> <li>• Progressive liberalization policies</li> </ul>	<ul style="list-style-type: none"> <li>• Development gap among members</li> <li>• Risk of falling into 'middle income trap'</li> <li>• Slow progress in domestic reforms</li> <li>• Low utilisation rate of preferential measures by the private sector</li> <li>• Aging population</li> <li>• Poor governance</li> <li>• Weak institutional capacity</li> <li>• Insurgency in member countries – Thailand, Myanmar</li> </ul>
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>• Momentum in Regional economic integration</li> <li>• Growth in services industries</li> <li>• Cooperation in health care activities</li> <li>• Investment in infrastructure</li> <li>• Rising 'middle class'</li> <li>• Increasing interest of the private sector</li> </ul>	<ul style="list-style-type: none"> <li>• Tensions in South China Sea</li> <li>• Slowdown in the US, the EU and the Chinese GDP growth</li> <li>• Vulnerability to financial markets</li> <li>• Competition from China in manufacturing and investment</li> <li>• Some competition from India in services</li> <li>• Climate change and environmental risk</li> <li>• Potential of infectious disease outbreak</li> </ul>

Source: Author's contribution

Nevertheless, these challenges will compel member-countries to shore up their strengths and fix their weaknesses. The growing competition from China, and to a lesser extent from India, will encourage ASEAN to hasten regional integration.

## A NEW AEC VISION

Taking into account these strengths and weaknesses (refer to Figure 1 for a summary), what are the variables that ASEAN should look at if it is to deepen its economic cooperation after 2015? The new AEC Vision must serve three regional objectives: (i) it should be economically desirable; (ii) it should be administratively and politically acceptable; and (iii) it should be developmentally achievable.

A region is '*economically desirable*' when its export industries span multiple countries, depending on their comparative advantage. Many economic assets, such as natural resources, agricultural lands, industries, recreational opportunities, a better quality of life, and high levels of innovation and entrepreneurship, are shared across the region. In order to serve this objective, ASEAN must build on what has already been achieved under the three pillars of the 2007 AEC Blueprint – single market and production base, a competitive economic region and a region connected to the global value chain. Looking at ASEAN's strengths and weaknesses, leaders need to work on the following issues.

### *Avoid the middle-income trap and raise economic competitiveness*

ASEAN countries like Malaysia, Thailand, the Philippines and Vietnam are either in or are about to enter the middle income trap. In order to help these countries, ASEAN needs to invest in knowledge, innovation and human resources. The governments' main focus should be to increase economic competitiveness through strong institutions, efficient infrastructure, better health, education and training, efficient labour and financial markets and more research, development and innovation.

### *Enhance connectivity to facilitate trade*

Trade facilitation refers to a full set of at- and behind-the-border policies, designed to ease the movement of goods across borders and hence reduce trade transaction costs. With a decrease in tariff barriers, the importance of trade facilitation is likely to be a significant feature of the international economy in years to come. ASEAN economic integration can enhance regional demand and deliver sustainable growth only when the policy makers address restrictive non-tariff measures, complicated and

time-consuming customs procedures, cross-country differences in legal and regulatory regimes and poor transport infrastructure. In future, ASEAN needs to increase its connectivity to other economies in the Asian region (China, India, Japan, South Korea, Australia, New Zealand).

#### *Explicit focus on services sector liberalisation*

ASEAN should give explicit attention towards increasing services sector trade and investment across borders. This is because sectors such as Information and Communication Technologies (ICT) can impact on producer services like transport, communications, finance and business services, which are then linked to ASEAN manufacturers for participation in international supply chains.

#### *Public-Private-Partnership Mode of Investment*

After preparing a high-class regional investment document like the ACIA, ASEAN should pay more attention to the investments. For an investor, there is no difference between an investment in goods and an investment in services. Both go hand-in-hand. Also, ASEAN is promoting the PPP model of funding for its big cross border infrastructure project. It is in the best interest of ASEAN to deliver on a regional PPP investment document.

#### *Deepen financial sector cooperation*

Although ASEAN will not seek financial and monetary integration anytime soon, it has discussed an ASEAN Bond Market Initiative for promoting long-term investment and financial stability. This will to be an extended process. Nevertheless, it is worthwhile for ASEAN to look for greater cooperation in the monetary and financial sector. Empirical studies have shown that monetary cooperation strongly affects trade and investment flows.

#### *Identify new priority integration sectors*

Beyond 2015, ASEAN should move up the value chain of production and identify new priority integration sectors. This can for example be the food processing industry, since agriculture contributes around 50 per cent to Myanmar's, and 33 per cent to Cambodia's GDP. The food-processing sector contributes 3.5 per cent and 13.5

per cent of total GDP in Indonesia and the Philippines respectively. The maritime or ship building industry can also be priority sectors. Malaysia and Singapore are emerging fast after China, South Korea and Japan as the world's largest shipbuilding nations. Other industries where ASEAN can have comparative advantage are in film making, healthcare devices and hospitality.

### *Expand free trade area (FTA) partners*

Continuing with its motto of open regionalism, ASEAN can look for expanding its FTA partnership to the USA and the EU. This will also serve the final goal of the Regional Comprehensive Economic Partnership (RCEP) agreement to achieve an FTA for the Asia-Pacific.

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The above recommendations will allow the new AEC Vision to be economically desirable. Second, deeper economic cooperation must be '*administratively and politically acceptable*'. This implies that measures adopted to achieve economic integration should not involve large administrative costs, especially where less developed member countries are concerned. Moving to a new phase of integration, ASEAN should be more mindful of its less developed members. It should insist on sharing a common vision not only among the trade and foreign ministries of the member countries but also among key agencies (customs, telecommunication, transport, health, central banks) and among provincial and municipal governments.

However, if the promises made for an economic community are not politically acceptable, it risks slowing down the implementation process and the regional organisation may lose its credibility. This is a pertinent issue for ASEAN, because even if ASEAN has a good regional document (such as the ASEAN Comprehensive Investment Agreement or Mutual Recognition Agreement of Professionals), there is little evident support in the form of domestic reforms. Such support can sometimes be embedded in slow-moving legislations. ASEAN should therefore seek new modalities of regionalism that lean more towards deepening co-operation, reducing rigidity and inculcating more pragmatism.

Last, and most crucial, any economic integration should lead to economic development i.e. '*developmentally achievable*'. This builds on AEC's original third pillar of equitable economic development. ASEAN should continue with its efforts to promote SMEs in the region and tackle the difficulties of capital and knowledge through a combination of 'hard' measures, such as direct investment; and 'soft' ones, notably

the provision of business support services, training, an innovative environment, financial engineering and technology transfer, as well as the creation of networks and clusters.

In order to narrow the developmental gap in the region, ASEAN should look for new modalities. One possible way is a nationalistic approach where funding and necessary support are provided to targeted countries and to targeted industries. Another drastic possibility is for ASEAN to establish a regional development bank, which will help nurture regional identity and solidarity. This bank can channel its lending to less developed areas. Moving ahead, ASEAN should address some 21<sup>st</sup> century issues in its new economic blueprint, such as climate change, environment protection, green technology and food security.

## OTHER CROSS-CUTTING INITIATIVES

One of the cross-cutting measures that ASEAN must look at beyond 2015 is the issue of *governance*. Strategic and coherent planning at all levels is a vital first step. This will need to be supported by good governance. In order to achieve this, it is necessary for ASEAN countries to strengthen institutional capacity, and performance and transparency of public administrations.

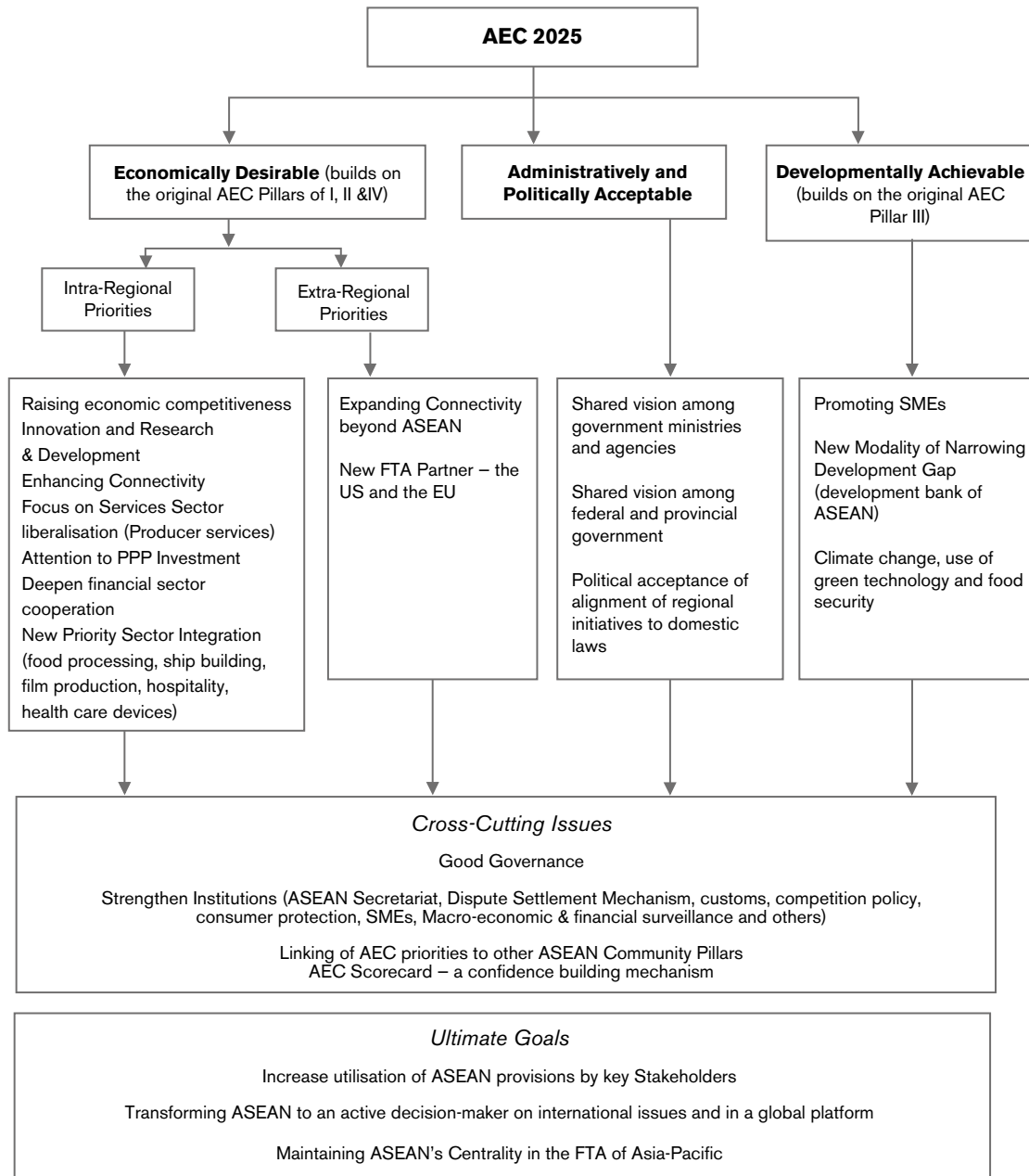
The next AEC vision should consider linking issues from other ASEAN Pillars – the security-political pillar and the socio-cultural pillar. This should for example involve the maintaining of ASEAN Centrality across all three pillars or making sure that the movement of labour is present in both the economic and socio-cultural pillars.

For the future, ASEAN must also strengthen its economic scorecard so that it can serve as an unbiased assessment tool for the extent of integration among its members and for the economic health of the region. It should also provide relevant information about regional priorities and in this way foster productive, inclusive and sustainable growth. Moreover, these scores should create incentives for improvement by highlighting what is working and what is not.

This entire framework is depicted in Figure 1.



**Figure 1: AEC 2025 – Objectives and Priorities**



Source: Author's contribution

## TIMELINE FOR THE NEW VISION

ASEAN should not look further than to 2025 as a deadline for its next vision statement. This is because the global economy is rapidly changing. ICT is paving the way for innovation, increased production and rapid diffusion of ideas in technology. In this scenario of changing circumstances, ASEAN should make continuous adjustments to its strategies and, therefore, should not take too long to realise its next vision statement. Moreover, ASEAN has had a history of preponing its deadline. This happened in January 2007, when the Leaders decided to hasten the establishment of the AEC by 5 years, and move the deadline to 2015.

## CONCLUSION

Indeed, 31st December 2015 is going to be a historic milestone for ASEAN when it announces the establishment of an economic community. The AEC will not look like the European Union. The institutional and the international economic environment facing ASEAN in the 21st century is far different than that of the European Economic Community (EEC) in the 1950s. What ASEAN will deliver is an FTA plus arrangement, meaning that there will be an increase in the flow of goods, services and investment across borders with additional provisions on labour and capital. With its *Plus 1* FTA, AEC will be viewed as an outward-oriented community.

AEC 2025 should aim for an economically desirable, politically acceptable and developmentally achievable region. Delivering on its promises will help ASEAN collectively, not only to gradually transform itself from a passive participant on global rule-making to an active decision-maker on a global platform but also help ASEAN to maintain its Centrality in a future FTA of the Asia-Pacific.

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