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Fighting irrelevance: An economic community
'with ASEAN characteristics'

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Abstract

The Association of Southeast Asian Nations (ASEAN) enters its fifth decade of economic cooperation in more favourable circumstances than those experienced at the time of its thirtieth anniversary. Paradoxically, and contrary to expectations at the time, the financial crises of 1997–98 may have strengthened ASEAN. The backlash against what was perceived as an unsympathetic Western response to East Asian difficulties put ASEAN at centrestage in new regional cooperative arrangements. Moreover, rivalry between China and Japan for regional leadership has led them both to seek to negotiate regional partnerships with ASEAN as a whole. ASEAN, however, faces new challenges—particularly from rapid economic growth in China and India, and from the proliferation of preferential trade agreements (PTAs) (including a large number involving individual ASEAN members). ASEAN has made only slow progress in economic cooperation. The complete removal of tariffs has fallen behind schedule and is not due to be realised until 2010. The private sector makes little use of ASEAN's preferential arrangements because they afford little advantage over most-favoured-nation tariffs—certainly not sufficient to offset the costs of complying with paperwork, and the consequent delays experienced. ASEAN has made little progress on 'deeper integration' issues—the removal of 'beyond border' barriers to trade. Some of the bilateral PTAs that ASEAN countries have negotiated with extra-regional partners go further in removing barriers than ASEAN's own arrangements. ASEAN members continue to eschew binding commitments within their own economic collaboration despite making them within the World Trade Organization and in some of their bilateral PTAs. Liberalisation under ASEAN's auspices has not been sufficiently significant to encourage business groups to invest substantial resources in lobbying for deeper integration.

Fighting irrelevance: An economic community 'with ASEAN characteristics'

JOHN RAVENHILL

What East Asia needs now is management, not vision. And the need is pressing.¹

The circumstances could hardly have been less propitious when the Association of Southeast Asian Nations (ASEAN) entered its fourth decade in late 1997. The region was embroiled in a major financial crisis, which ASEAN proved powerless to address. The long-anticipated expansion of the grouping's membership to embrace the whole of Southeast Asia had been thwarted by political upheavals in Cambodia. And China's rapid economic development appeared to cast a cloud over ASEAN's long-term growth prospects.

ASEAN not only survived the crisis but, to the surprise of many commentators, appeared to emerge somewhat strengthened by it. Two factors were particularly significant in this unexpected resurgence. First, a backlash against the Western response to the crisis prompted East Asian states to forge improved regional mechanisms for inter-state collaboration, not only to enhance economic cooperation within the region but also to improve the region's bargaining situation with extra-regional partners. Given the rivalry between China and Japan for regional leadership, the way was open for ASEAN to seize centrestage in promoting a new regional partnership. ASEAN's prominence was reinforced by China's offer, at the China-ASEAN summit in 2000, to explore the possibility of negotiating a free trade agreement (FTA) with ASEAN as a whole. The subsequent framework agreement for an FTA concluded between the two parties placed both Japan and Korea on the back foot. They in turn sought agreements with ASEAN as a whole.

¹ Richard E. Baldwin, 'Managing the noodle bowl: The fragility of East Asian regionalism', ADB Working Paper Series on Regional Economic Integration No. 7 (Manila: Asian Development Bank, February 2007), <http://aric.adb.org/pdf/workingpaper/WP07_Baldwin.pdf>, p. 3.

Second, ASEAN members breathed new life into their faltering economic cooperation through launching a number of initiatives in the aftermath of the financial crises. Most notable among these was the adoption at the Second Informal ASEAN Summit in Malaysia in December 1997 of 'ASEAN Vision 2020'. Members committed themselves to full implementation of the ASEAN Free Trade Area (AFTA—launched in 1992 in response to the perceived economic threat from China), to accelerate liberalisation of trade in services, to realise the ASEAN Investment Area by 2010 and free flow of investments by 2020, and to facilitate the free flow of professional and other services in the region.²

At their subsequent summit in Hanoi in December 1998, ASEAN leaders agreed to an acceleration of the implementation of AFTA, bringing the deadline for completion for the original six signatories of the agreement (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) forward by one year from 2003 to 2002, at which point 100 per cent of items in the countries' Inclusion Lists would have tariffs of zero to 5 per cent 'with some flexibility'.³ Members would also offer additional incentives to investors in manufacturing. The Hanoi Plan of Action, adopted at the same summit, was a six-year framework for the implementation of ASEAN Vision 2020. The plan specified targets for the liberalisation of trade in merchandise and services, the harmonisation of customs regulations and of product standards, and for the implementation of a Framework Agreement on the ASEAN Investment Area. Members also pledged to strengthen collaboration to promote food security, enhance private sector participation, intensify industrial cooperation, cooperate further on intellectual property issues, and promote small and medium enterprises (but no targets or specific means for furthering collaboration were detailed).⁴

² ASEAN Secretariat, 'ASEAN vision 2020', 1997, <www.aseansec.org/5228.htm>.

³ ASEAN Secretariat, 'Statement on bold measures, 6th ASEAN summit, Hanoi, 16 December 1998', <www.aseansec.org/8756.htm>. In AFTA, members are required to assign tariff lines to one of four lists: the Inclusion List, the Temporary Exclusion List, the 'Highly Sensitive' List and the 'General Exception' List. For the six original signatories of AFTA, close to 99 per cent of tariff lines are on the Inclusion List; for Cambodia, Laos, Myanmar, and Vietnam, the figure is only 72 per cent (primarily because of continued protectionism in the first three of these countries: for Vietnam, which made impressive progress in trade liberalisation, the figure is 97 per cent).

⁴ ASEAN Secretariat, 'Hanoi plan of action', 1998, <www.aseansec.org/8754.htm>.

Some member states soon realised, however, that these modest advances on existing cooperation in ASEAN provided little foundation for coping with the new challenges that ASEAN faced. ASEAN increasingly found itself caught in a pincer movement—from the North, China's economy continued to grow more rapidly than its ASEAN counterparts; ASEAN governments were particularly concerned about the potential loss of foreign investment given the increased attractiveness of China following its accession to the World Trade Organization (WTO) in 2001.⁵ And, from the West, India was rapidly emerging as 'Asia's next giant', with an acceleration of its economic growth following increased opening to the global economy, creating another competitor across many economic sectors. The first years of the new millennium also saw a proliferation of bilateral agreements in East Asia, a trend in which ASEAN member states were increasingly active participants. ASEAN's response to the new challenges was the adoption of the Bali Concord II at its Ninth Summit in 2003, in which the grouping resolved to establish an ASEAN Economic Community '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'.⁶

This paper evaluates ASEAN's performance in fostering economic collaboration during the institution's fourth decade. It does not seek to assess ASEAN's overall record or to address the issue of whether cooperation on economic matters, regardless of its effectiveness, may have played an important role in confidence-building among member economies and thus in facilitating improved inter-state relations.

FROM FREE TRADE AREA TO ECONOMIC COMMUNITY?

The ineffectiveness of the ASEAN Free Trade Area

ASEAN began implementing its free trade agreement in 1993. In the years following the original declaration, the good intentions to promote economic cooperation were undermined by a lack of precision of the

⁵ See John Ravenhill, 'Is China an economic threat to Southeast Asia?', *Asian Survey*, 46(5) 2006: 653–74, for discussion of whether such fears were warranted.

⁶ ASEAN Secretariat, 'Declaration of ASEAN Concord II (Bali Concord II)', 2003, <www.aseansec.org/15159.htm>.

obligations that members had agreed to, by frequent changes of target dates for implementation, which caused uncertainty for investors, and by the failure of members to honour the commitments they had made.⁷ ASEAN's definition of free trade was an unusual one—the implementation of tariffs that were in the zero to 5 per cent range (the top of this range being above the average tariff level that industrialised countries imposed on imports of manufactures once they fully implemented the WTO's Uruguay Round commitments). The lack of uniformity in treatment of individual products by various ASEAN countries in effect caused traders to face not a single free trade area but what Richard Baldwin has characterised as 45 bilateral preferential agreements within the ASEAN market.⁸

ASEAN's acceleration of the implementation of AFTA did help somewhat to reduce the problem of uncertainty caused by different national tariffs for individual projects. By the end of 2006, 99.8 per cent of the tariff lines of the six original AFTA signatories (the 'ASEAN6') had been brought within the zero to 5 per cent range required by AFTA.⁹ The average tariff level was 2.39 per cent, down from 12.76 per cent in 1993 when implementation of AFTA commenced.¹⁰ On the other hand, the complete freeing of trade between the six economies had fallen behind schedule. ASEAN failed to meet its target of zero tariffs for 60 per cent of the lines by 2003, with only Brunei, Malaysia and Singapore reaching this goal. For the Philippines, only 3.8 per cent of tariffs had been reduced to zero by the deadline, for Indonesia 54.6 per cent, and for Thailand 4.3 per cent. By the end of 2006, only 65 per cent of the products in the Inclusion Lists of the ASEAN6 had zero tariffs. Complete removal of all tariffs on goods was not

⁷ John Ravenhill, 'Economic cooperation in Southeast Asia: Changing incentives', *Asian Survey*, 35(9) 1995: 850–66.

⁸ Baldwin, 'Managing the noodle bowl', p. 12.

⁹ Ong Keng Yong, 'Challenges and prospects for the ASEAN economic community: Remarks by HE Ong Keng Yong, Secretary General of ASEAN, at the ASEAN Gala Dinner, London, 4 December 2006', <www.aseansec.org/19002.htm>.

¹⁰ Cielito F. Habito, Fernando T. Aldaba and Ofelia M. Templo, 'An assessment study on the progress of ASEAN regional integration: The Ha Noi plan of action toward ASEAN vision 2020', REPSF Project 03/006b (Jakarta: Regional Economic Policy Support Facility, ASEAN–Australia Development Cooperation Program, ASEAN Secretariat, October 2004), p. 19.

scheduled to occur until 2010 for the ASEAN6, and 2015 for the newer members.

The uncertainty as to how products would be treated in individual markets was one reason why the private sector made little use of the preferential arrangements established by AFTA, an uncertainty compounded by inconsistent rules of origin and the absence of dispute settlement mechanisms in the agreement. More important, however, was that, following the unilateral trade liberalisation ASEAN states pursued in the 1980s and 1990s, the preferential margins created by AFTA for the vast majority of intra-ASEAN trade were so low that few companies found that their potential benefits offset the risk of delays and the costs of completing the paperwork required to comply with the treaty's rules of origins. Table 1 presents data on the average tariffs imposed in 2003 by the six original AFTA signatories on imports from outside (the most-favoured-nation rate) and from within ASEAN (the common effective preferential tariff). Only in Thailand's case was there a very large gap between the two rates.

Table 1: Comparison of average most-favoured-nation (MFN) and AFTA's common effective preferential tariff (CEPT) rates 2003 (%)

	MFN	CEPT
Brunei	3.1	1.04
Indonesia	7.3	2.17
Malaysia	9.2	1.95
Philippines	7.8	3.82
Singapore	0	0
Thailand	18.6	4.63

Source: Compiled from data in David J. Dennis and Zainal Aznam Yusof, 'Developing indicators of ASEAN integration—a preliminary survey for a roadmap', REPSF Project 02/001 (Jakarta: Regional Economic Policy Support Facility, ASEAN–Australia Development Cooperation Program, ASEAN Secretariat, August 2003), pp. 4–5.

These, however, were the *average* tariff levels. For the major categories of products in intra-ASEAN trade—computer and electronic equipment and components, and fuels—the average MFN tariff was less than 2 per cent,

with many of the computer products and components covered by the WTO's Information Technology Agreement.¹¹ Scarcely surprising, therefore, that various studies have shown that only a tiny percentage of intra-ASEAN trade took advantage of the preferential tariffs created by AFTA—typically less than 5 per cent of overall trade, a much smaller percentage than for preferential arrangements in Europe, for instance.¹² The issue here is not that tariff rates were significant barriers to intra-ASEAN trade, at least for the original signatories of AFTA. They were not. Rather, it is that AFTA added little to the trade liberalisation undertaken unilaterally by Southeast Asian states. If AFTA was to act as a significant stimulus to intra-ASEAN trade, advantages would have to be created on issues other than tariffs.

Progress in other areas of economic collaboration, however, was even more unimpressive than in the removal of tariffs on merchandise trade. In an era of generally low tariffs, 'beyond-border' barriers are often more significant obstacles to trade than are tariffs themselves. ASEAN has failed to address these issues seriously. Members failed to meet a 2005 deadline for agreement on criteria for identifying non-tariff barriers (NTBs). Although the ASEAN Secretariat now maintains a list of NTBs that individual states impose, one study suggested that few members had provided a comprehensive list to the Secretariat.¹³ And, as the former ASEAN Secretary-General Rodolfo Severino commented, it would be far more useful to have a list compiled from NTBs that businesses reported to have encountered rather than one of barriers whose existence governments were willing to acknowledge.¹⁴ ASEAN simply has not taken effective action to address problems such as coordination of customs procedures, and the harmonisation

¹¹ The Information Technology Agreement (ITA) provides for duty-free import of most IT components and products. Of the ASEAN members, Indonesia, Malaysia, the Philippines, Singapore, and Thailand are parties to the ITA. In 2005, electrical machinery constituted 29 per cent of total intra-ASEAN trade; fuel oils a further 20 per cent, and machinery (a category that includes household appliances such as air conditioners, washing machines, refrigerators, and machine tools and office machinery) 16 per cent (ASEAN External Trade Statistics, <www.aseansec.org/18137.htm>); Robert R. Teh Jr, 'Completing the CEPT scheme for AFTA', paper presented at conference on 'Beyond AFTA and towards an ASEAN common market', Makati City, 19–20 October 1999.

¹² McKinsey and Company, 'ASEAN competitiveness study' (Jakarta: ASEAN Secretariat, 2003).

¹³ Habito, Aldaba and Templo, 'An assessment study', p. 50.

¹⁴ Rodolfo Severino, *Southeast Asia in search of an ASEAN community: Insights from the former ASEAN Secretary-General* (Singapore: Institute of Southeast Asian Studies, 2006), p. 348.

of product standards and technical regulations. ASEAN did identify 20 priority products for which harmonisation of standards was to be achieved by 2000; by 2002, however, only four countries had fulfilled this commitment.¹⁵

In the services sector, little progress on liberalisation had occurred despite the signature in 1995 of an ASEAN Framework Agreement on Services. As a consequence, growth of services trade within ASEAN was slower than the world average—in marked contrast to trade in goods.¹⁶ Some countries had liberalised market access and made progress on the provision of national treatment to investors from other ASEAN economies but ASEAN had not begun to address other key issues such as movement of natural persons or mutual recognition of labour standards. And, as the ASEAN Secretary General, Ong Keng Yong, acknowledged in December 2006, 'ASEAN has yet to embark ... on the harmonization and standardization of laws and regulations on business and on competition'.¹⁷

ASEAN's progress on economic integration accordingly paled in comparison not only with that achieved within the European Union but also with that in other less ambitious integrative arrangements. Table 2 illustrates how ASEAN in many areas lagged behind the North American Free Trade Agreement (NAFTA) and the South American MERCOSUR as well as the European Union (EU).

Two developments in the early years of the twenty-first century highlighted the weaknesses of the existing state of ASEAN economic cooperation. The first was the negotiations that occurred between ASEAN as a grouping and regional economic partners—first China, then Japan and Korea (and most recently with the Australia–New Zealand Closer Economic Relations Trade Agreement). Although, as argued at the beginning of this paper, the agreements with China and Japan in particular did help to revitalise ASEAN after the financial crisis, they also had the effect of

¹⁵ Habito, Aldaba and Templo, 'An assessment study', p. 19.

¹⁶ Christopher Findlay, 'Services trade liberalization in ASEAN', in Denis Hew (ed.), *Roadmap to an ASEAN economic community* (Singapore: Institute of Southeast Asian Studies, 2005), pp. 172–95; Peter Lloyd and Penny Smith, 'Global economic challenges to ASEAN integration and competitiveness: A prospective look', REPSF Project 03/006a (Jakarta: Regional Economic Policy Support Facility, ASEAN–Australia Development Cooperation Program, ASEAN Secretariat, September 2004).

¹⁷ Ong Keng Yong, 'Challenges and prospects'.

Table 2: ASEAN economic integration in comparative perspective

	EU	NAFTA	MERCOSUR	ASEAN
Goods				
Elimination of tariffs	Y	Y	Y	P
Elimination of NTBs	Y	Y	Y	P
Elimination of government procurement barriers	Y	Y	N	N
Prohibition of export incentives	Y	Y	N	N
National treatment	Y	Y	P	N
Harmonisation/mutual recognition of product standards	Y	N	N	P
Services				
Market access	Y	Y	P	P
Temporary movement of businesspeople	Y	Y	P	N
National treatment	Y	Y	Y	P
Mutual recognition labour standards	Y	N	N	N
Capital Markets				
MFN treatment	Y	Y	Y	Y
Rights of establishment	Y	Y	Y	P
National treatment	Y	Y	Y	Y
Prohibition of performance requirements	Y	Y	N	N
Prohibition of investment incentives to foreign investors	Y	N	N	N
Harmonisation of business laws	Y	N	N	N
Harmonisation of corporate taxation	P	N	N	N
Labour Markets				
Temporary movement of persons	Y	Y	P	N
Other Measures				
Regional/bilateral cooperation on competition law	Y	N	Y	N
Monetary union	Y	N	N	N

Y = Full Liberalisation; N = Not Addressed; P = Partial Liberalisation

Source: Derived from Lloyd and Smith, 'Global economic challenges', Table 4.1.

exposing its weaknesses.¹⁸ One was that ASEAN itself had no international legal personality. The Secretariat, unlike the European Commission, was not empowered to negotiate on ASEAN's behalf. This problem was compounded by the absence of a common external tariff and therefore identical treatment for imports in all ASEAN markets. Although the treaties were ostensibly with ASEAN as a whole, prospective partners inevitably had to negotiate with individual ASEAN countries.

The fragility and shallowness of ASEAN's economic integration was further exposed by the other significant development in the foreign economic policies of the region in the early years of the new century: the proliferation of bilateral free trade agreements. By early 2007, individual ASEAN countries were implementing, negotiating or conducting studies on 59 preferential trade agreements with other countries or groupings.¹⁹ At the very least, conclusion of these agreements could be expected to remove any tariff advantages in merchandise trade that AFTA conferred on ASEAN partners. But, even more significantly, some of these agreements proposed 'deeper' integration than ASEAN itself had achieved. This was particularly the case for agreements involving the United States (with Singapore having concluded a treaty in May 2003, and Malaysia and Thailand negotiating with Washington), and to a lesser extent for those with Japan and with Australia. These agreements are 'WTO Plus' in nature, involving not just trade in goods but also in services, and typically contain provisions on intellectual property rights, competition policies, and so on. With full implementation of these agreements typically scheduled to occur within ten years of their signature, ASEAN countries faced the anomaly of having committed themselves to give more favourable treatment to extra-regional partners than they were scheduled to provide to their partners in ASEAN—entirely against the 'ASEAN First' principle that supposedly underlay Southeast Asia's regional collaboration on foreign economic policies.

¹⁸ And, some have suggested, may have diverted attention and energy away from intra-ASEAN cooperation.

¹⁹ As is clear from Table 3, the distribution of agreements across ASEAN countries is very uneven with ASEAN's newest members, Cambodia, Laos, Myanmar, and Vietnam, generating little interest as potential partners for extra-regional countries.

Table 3: Bilateral/minilateral PTAs involving ASEAN and its member countries in March 2007

Country	Implementing	Negotiating	Study group
ASEAN	AFTA, China, Korea*	Australia–New Zealand, India, Japan	US
Brunei	AFTA, Chile–New Zealand–Singapore***	Japan	US
Cambodia	AFTA		
Indonesia	AFTA	Japan	European Free Trade Area (EFTA), India, Pakistan, US
Laos	AFTA, Thailand		
Malaysia	AFTA, Japan	Australia, New Zealand, Pakistan, US	Chile, India, Korea
Myanmar	AFTA, BIMSTEC**		
Philippines	AFTA, Japan		Pakistan, US
Singapore	AFTA, Australia, EFTA, India, Japan, Jordan, Korea, New Zealand, Panama, US, Brunei-Chile-New Zealand***	Bahrain, Canada, China, Egypt, Kuwait, Mexico, Pakistan, Peru, Qatar	Sri Lanka, United Arab Emirates
Thailand	AFTA, Australia, Bahrain, China, India, Japan, Laos, BIMSTEC**	Bahrain, EFTA, New Zealand, Peru, US	Chile, Korea, MERCOSUR, Pakistan
Vietnam	AFTA	Japan	

* Excludes Thailand, which refused to sign after Korea excluded rice and 200 other agricultural products from the agreement.

** Bay of Bengal Initiative for MultiSectoral Technical and Economic Cooperation (Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, Thailand).

*** Trans-Pacific Strategic Economic Partnership Agreement.

In short, ASEAN had saddled itself with a mid-twentieth century form of regional economic cooperation that was ill-equipped to cope with twenty-first century challenges. Summing up the state of ASEAN economic

integration in 2002, the then Secretary-General of ASEAN, Severino commented:

the process of integration has generally stalled. To be sure, some progress has been made, notably in AFTA, but progress has fallen short of measuring up to the challenges faced by our region and carrying out the leaders' vision and resolve. AFTA has seen little actual use by traders. The other foundations for regional integration have not been built upon. Regional economic integration seems to have become stuck in framework agreements, work programmes, and master plans.²⁰

Responding to increasing criticism of the ineffectiveness of ASEAN Economic Cooperation and fears on the part of leaders of its more advanced economies that this was contributing to the decline in foreign direct investment inflows that ASEAN experienced after the financial crises, ASEAN Economic Ministers in May 2002 commissioned a comprehensive study from the management consultants, McKinsey and Company, into ASEAN competitiveness. The bluntness of the report's message undoubtedly shocked some ASEAN governments. The report concluded that 'ASEAN countries are less a unified market for goods and services than a collection of disparate markets' and that this fragmentation generated 'higher costs, uncertainty, and subscale markets'. These problems were compounded by 'unpredictable policy implementation'. Potential foreign investors consequently were deterred. Integration of the ASEAN market was estimated to have the potential to raise regional GDP by 10 per cent, and to reduce the cost of manufacturing in the region by between 10 and 20 per cent.²¹ The McKinsey report was completed in August 2003: its recommendation that the acceleration of ASEAN economic integration should be addressed through identifying a number of priority sectors was taken up by ASEAN leaders at their summit in Bali later that year. But the leaders went beyond the McKinsey report in committing themselves to the establishment of an ASEAN Economic Community, one of three 'pillars' of an ASEAN Community to be realised by 2020.

²⁰ Severino, *Southeast Asia in search of an ASEAN community*, p. 344.

²¹ A summary of the report appeared in Adam Schwarz and Roland Villingier, 'Integrating Southeast Asia's economies', *McKinsey Quarterly*, 1, 2004, <www.mckinseyquarterly.com/article_page.aspx?ar=1392&L2=7&L3=8>.

THE ASEAN ECONOMIC COMMUNITY

The Bali Concord II adopted in 2003 is a typical ASEAN document: full of well-meaning phrases but almost entirely devoid of specificity regarding the mechanisms through which the objectives will be realised.

Indeed, to exactly what ASEAN leaders were committing themselves in pledging to establish an ASEAN Economic Community was far from clear. The concept of 'Economic Community' suggested a substantially deeper economic integration than had been achieved through the implementation of AFTA over the previous decade. This was reinforced by the statement that 'The ASEAN Economic Community shall establish ASEAN as a single market and production base, turning the diversity that characterises the region into opportunities for business complementation making the ASEAN a more dynamic and stronger segment of the global supply chain'.²² Following the logic of the McKinsey report, the emphasis was strongly on furthering ASEAN's integration into global production networks.

But how did ASEAN leaders conceive of a single market and how it might be realised? A commitment to a 'free flow of goods, services, investment' seems straightforward enough but the qualifier in the commitment to a '*freer* flow of capital' immediately suggested a hedging that critics saw as all-too-characteristic of ASEAN's history of 'flexible' commitments to economic integration.

As Peter Lloyd and Penny Smith suggest,²³ for economists the idea of a single market has a specific meaning: it is a geographical area in which the 'Law of One Price' applies, that is, there should be a single price throughout the regional market for every tradable commodity and factor of production, after adjustment is made for transport costs. The McKinsey report had made specific comments about how prices for the same product differed significantly across ASEAN economies. For the law of one price to be realised, not only must border barriers be removed but so too any other sources of discrimination (including those introduced by national taxation systems) between domestic goods, investors, and labour and those coming from other parts of the region. Realisation of a single market thus defined would require the harmonisation of national tax rates, competition

²² ASEAN Secretariat, 'Declaration of ASEAN Concord II', paragraph B3.

²³ Lloyd and Smith, 'Global economic challenges'.

principles, and product standards. Some suggest on the basis of European experience that realisation of a truly integrated market will also require the adoption of a common external tariff and 'deep' monetary cooperation (at least a currency basket to facilitate intra-regional transactions if not a common currency).²⁴

Reference to a common external tariff immediately points to significant difficulties that ASEAN would experience in attempting to move to a truly integrated single market. The first is accommodating Singapore's open economy. Singapore's average MFN tariff is already zero: given Singapore's dependence on international trade, it would be inconceivable for the island state to agree to raise its tariffs to comply with an ASEAN common external tariff (CET) that was set at above zero. Two possible solutions exist for this problem. First, ASEAN as a whole could set its CET at zero, which would be consistent with the grouping's external orientation and the emphasis in the Bali Concord on the importance of establishing ASEAN as a competitive global production base. The second would be for other ASEAN members to agree to a non-zero CET, leaving Singapore as a free port—but this would have administrative complications that would inhibit the reduction of transactions costs the adoption of a CET is intended to achieve.

A zero CET would cause a different set of problems, namely, it would deprive member states of tariff revenue, a significant source of government income for the least developed economies, especially Cambodia. The need to accommodate the particular problems faced by ASEAN's newest members is the second major difficulty that ASEAN will face in moving towards a single market. The diversity of ASEAN economies remains greater than that of other regional groupings when measured in terms of per capita income.²⁵ ASEAN has become increasingly conscious of the

²⁴ Michael G. Plummer, 'Creating an ASEAN economic community: Lessons from the EU and reflections on the roadmap', in Denis Hew (ed.), *Roadmap to an ASEAN economic community* (Singapore: Institute of Southeast Asian Studies, 2005), pp. 31–62; Michael G. Plummer and Reid W. Click, 'Bond market development and integration in ASEAN', *International Journal of Finance and Economics*, 10(2) 2005: 133–42.

²⁵ Whereas the ratio of the highest (Singapore) to lowest (Laos) per capita income in ASEAN measured in purchasing power parity terms is more than 15:1, the equivalent ratios for NAFTA (US:Mexico) and the EU (Luxembourg:Romania) are approximately 4:1 and 7:1 respectively. If Singapore is excluded as an outlier, however, the ratio between the next highest per capita income, Malaysia, and Laos is 5:1. (The World Bank data do not include GDP information for Myanmar).

obstacles to deeper integration posed by intra-regional inequalities.²⁶ Far greater attention has been given to capacity-building in the weaker states—with mixed results.²⁷ But unlike the EU, it has not developed any mechanisms for fiscal transfers from the wealthier to the poorer economies. The principal concession to its low-income states, a status that overlaps with the newest members, has been to allow them longer adjustment periods to implement agreements. In its report to ASEAN leaders, the Eminent Person's Group²⁸ charged with formulating proposals for an ASEAN Charter suggested that a 'special fund' for 'narrowing the development gap' should be established but that this should be financed by voluntary contributions from member states—hardly likely to provide certainty to the lower income economies that any substantial benefits will be coming to them.

The McKinsey report had recommended that ASEAN should deepen its economic cooperation through a sectoral approach, suggesting that the initial focus should be on liberalisation and standardisation in consumer goods and electronics. At its October 2003 leaders' meeting, ASEAN decided to go beyond these recommendations by accelerating liberalisation in 11 priority sectors, with six member economies having responsibility for coordinating work in the sectors.²⁹ The 11 sectors collectively accounted for 50 per cent of intra-ASEAN trade in 2003. For each of the sectors, a 'roadmap' to liberalisation was prepared, with the objective of removing

When the measure is overall size of the economy, however, the EU is now the most diverse grouping, with a ratio of more than 500 to 1 between Germany, the largest, and Malta, the smallest economy. Data from World Bank, <web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20535285~menuPK:1192694~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>.

²⁶ For the problems that this has caused for regional cooperation efforts see Natasha Hamilton-Hart, 'Asia's new regionalism: Government capacity and cooperation in the Western Pacific', *Review of International Political Economy*, 10(2) 2003: 222–45.

²⁷ An assessment of ASEAN's capacity-building programs found that training programs often attracted 'poor participation' in part because 'recipient countries did not always find such training programs relevant to their needs'. See Habito, Aldaba and Templo, 'An assessment study', p. xii.

²⁸ ASEAN Secretariat, 'Report of the Eminent Persons Group on the ASEAN Charter' (Jakarta: ASEAN Secretariat, December 2006), <www.aseansec.org/19247.pdf>.

²⁹ The priority sectors and countries responsible are: wood-based products and automotive (Indonesia); rubber-based products and textiles/apparel (Malaysia); agriculture-based products and fisheries (Myanmar); electronics (Philippines); IT linkages and health care (Singapore); and air travel and tourism (Thailand).

import duties by 2007 (for the ASEAN6, 2012 for newer members), three years ahead of the AFTA schedule. The roadmaps also focus on investment facilitation, and harmonisation/mutual recognition of product standards and testing certification.

The Cebu Leaders' Meeting in January 2007 adopted revised roadmaps for the various sectors.³⁰ It is evident from the published material that progress in liberalisation is far from complete and generally slower than anticipated. Moreover, the focus of current work remains predominantly on border barriers rather than on the 'deeper' beyond-the-border integration that will be required if ASEAN is to form an integrated economic community. For some sectors, e.g., automotive, preparatory studies were still to be completed in 2007. Harmonisation of automotive safety standards was not scheduled to be completed until 2008. The timeline for the removal of restrictive investment measures stretched to 2010 for the ASEAN6, 2013 for Vietnam, and 2015 for Cambodia, Laos and Myanmar. Measures in the tourism sector appear less ambitious than those proposed in the ASEAN Tourism Agreement, signed in 2002.³¹ Some states, particularly Cambodia, exempted from liberalisation a significant number of products in the automotive, textiles, and wood products sectors. In the services sector, some progress has been made in mutual recognition agreements—for instance, on nursing and engineering services. A comprehensive report on trade in services ten years after the implementation of the ASEAN Framework Agreement on Services concluded, however, that 'performance has not been impressive', and that the liberalisation achieved under the agreement had provided little preferential advantage beyond that offered by members through the General Agreement on Trade in Services (GATS).³²

ASEAN may be commended for attempting to accelerate liberalisation through the sectoral approach, and especially for tackling sectors such as automotive and textiles/apparel that had been particularly sensitive to

³⁰ All of which are available on the ASEAN Secretariat website, reflecting a significant improvement in the grouping's transparency in recent years. For details of the roadmaps see <www.aseansec.org/19399.htm>.

³¹ Severino, *Southeast Asia in search of an ASEAN community*, p. 349.

³² Vo Tri Thanh and Paul Bartlett, 'Ten years of ASEAN Framework Agreement on Services (AFAS): An assessment', REPSF Project 05/004 (Jakarta: ASEAN Secretariat, July 2006), p. xiii, <www.aadcp-repsf.org/cgi/axs/ax.pl?http://www.aadcp-repsf.org/docs/05-004-FinalReport.pdf>.

member states in previous years. The relatively recent implementation of the roadmaps precludes definitive judgements on whether ASEAN will meet its own deadlines. Nonetheless, the slow pace of liberalisation and the fragmentation across different markets does not bode well for the grouping's aspirations to create a single market that will be attractive to foreign investors. Incomplete agreements that are lacking in specificity do little to enhance confidence in the grouping's capacity to deliver on its commitment to a single market. But also, as has been the case throughout the history of ASEAN economic cooperation, the credibility of ASEAN's commitments comes under question because of the weakness of the grouping's political institutions, particularly their capacity for monitoring and enforcing the agreements that are reached.

The institutional reform imperative

ASEAN's problem is not one of lack of vision, ideas, or action plans. The problem is one of ensuring compliance and effective implementation. ASEAN must have a culture of commitment to honour and implement decisions, agreements and timelines.³³

ASEAN is infamous for the manner in which states have jealously guarded their sovereignty—seen in the unwillingness of members to provide the Secretariat with the resources needed to carry out its responsibilities for fear that it might somehow mushroom into a European Commission-style supranational body. Consensual decision-making and the flexible implementation of agreements are emblematic of a pathology of fear of commitment. Over the years ASEAN members appear to have confused a perhaps justified aversion to supranationalism with an unwillingness to accept binding commitments voluntarily entered into. With most ASEAN states now members of the WTO, and many entering binding FTA commitments with industrialised economies, a certain irony exists between their willingness to voluntarily sign on to these agreements and a continuing reluctance to commit within ASEAN itself. There is nothing in a free trade agreement that requires supranationalism—even

³³ ASEAN Secretariat, 'Report of the Eminent Persons Group', paragraph 6.

dispute settlement mechanisms can be handled, albeit with debatable effectiveness by national secretariats, as in NAFTA.

As many commentators have noted, ASEAN is unlikely to achieve its ambitious vision of establishing an economic community by 2015 (the revised deadline adopted by ASEAN leaders at the twelfth summit held in Cebu in January 2007) unless radical changes are made in its culture, its institutions and its decision-making procedures. ASEAN's culture has been one of voluntary commitment and compliance, of flexibility in the implementation and interpretation of obligations that members have negotiated at the regional level. As noted in the previous section of this paper, the consequence of this elastic resolve for its most significant economic project, the Free Trade Area, has been an incomplete agreement that fails to provide the certainty that foreign investors seek. The success of the proposed ASEAN Economic Community therefore will likely be determined by the fate of the ASEAN Charter, currently under deliberation by its member states.

A particularly significant gap in AFTA was the absence of effective dispute settlement mechanisms (DSMs). DSMs, of course, can only be effective if clarity exists on what members have actually agreed to. ASEAN members are moving, albeit slowly, towards accepting greater precision in their regional obligations, for example, by agreeing to the removal of all tariffs. But an enormous distance has still to be travelled before ASEAN has a set of agreements that are sufficiently specific that they could conceivably be legally enforceable. It is this lack of specificity in ASEAN agreements, coupled with the failure of member states to see their provisions as binding obligations, which are the principal problems. Commentators have placed a great deal of emphasis on the need to 'depoliticise' dispute resolution in ASEAN.³⁴ While an independent DSM within ASEAN would certainly be a significant institutional innovation, the emphasis on depoliticisation of dispute resolution to a considerable extent misunderstands the character of the dispute settlement process within the WTO. Consistent with John Gerard Ruggie's characterisation of postwar economic regimes as reflecting

³⁴ Hsu Locknie, 'The ASEAN community: Institutional implications', in ISEAS, *Towards realizing an ASEAN community: A brief report on the ASEAN community roundtable* (Singapore: Institute of Southeast Asian Studies, 2004), pp. 36–48.

the principle of ‘embedded liberalism’,³⁵ dispute settlement in the global trade regime has always been a political process. Even in the more legalised WTO, emphasis is placed on the parties negotiating a settlement themselves; the establishment of a dispute settlement panel is a last resort (and only about one-third of the disputes that are notified to the WTO end up before a panel).

The previous argument notwithstanding, the WTO’s DSMs have enormous significance simply by virtue of their very existence. For it is the possibility that disputes will go to adjudication that both encourages countries to comply with their obligations, and to resolve disputes when they arise. ASEAN’s decision to adopt a Protocol on Enhanced Dispute Settlement Mechanism³⁶ at its tenth summit in Vientiane in 2004 therefore arguably marked a substantial step towards re-shaping institutional culture. Nonetheless, as former Secretary-General Severino points out, the new mechanism appears to assume that the Senior Economic Officials, who have responsibility for adopting a dispute panel report, will operate on consensus (a requirement that undermined the General Agreement on Tariffs and Trade’s (GATT) dispute-settlement procedures).³⁷ The Senior Economic Officials can also reject a report by the Appellate Body. Moreover, the effectiveness of the new mechanisms will depend not just on their existence but on the willingness of states to make use of them: this has yet to be tested. Members never had recourse to a 1996 protocol on dispute settlement, and their use of the new procedures would mark a radical departure from established ASEAN norms.

Failure of member states to honour the commitments that they have made within ASEAN also reflects the lack of effective monitoring procedures within the grouping. In turn, this highlights the weakness of the ASEAN Secretariat. Although the Secretariat was strengthened somewhat in 1993 after the commitment to introduce AFTA, with the title of its chief executive officer being amended to Secretary-General of ASEAN, and an open recruitment process introduced, it remains drastically understaffed for

³⁵ John Gerard Ruggie, ‘International regimes, transactions, and change: Embedded liberalism in the postwar economic order’, *International Organization*, 36(2) 1982: 379–415.

³⁶ ASEAN Secretariat, ‘ASEAN protocol on enhanced dispute settlement mechanism’, 2004, <www.aseansec.org/16754.htm>.

³⁷ Severino, *Southeast Asia in search of an ASEAN community*, p. 354.

the tasks that it will be required to perform if the ASEAN Community is to be realised within the next decade. The Eminent Persons Group report on the ASEAN Charter fails to suggest explicitly that the Secretariat should have a role in monitoring the implementation of agreements, asserting merely that 'more openly-recruited professional staff may need to be employed' to upgrade the Secretariat's capacity to 'carry out research and analytical work'.³⁸

The other major area where institutional reform is required is in ASEAN's decision-making procedures. Decision-making on the basis of consensus may have served ASEAN well during its early days when the need for confidence-building was paramount. In an era when decisions need to be made and implemented rapidly to ensure that an integrated ASEAN market remains competitive, proceeding on a lowest common denominator basis will simply be ineffective. The reality is that some countries are far more important for the regional economy than are others. Four countries—Indonesia, Malaysia, Singapore, Thailand—account for more than 85 per cent of intra-ASEAN trade (Table 4). Four other members—Brunei, Cambodia, Laos, Myanmar—each for less than 1 per cent.

Table 4: Country shares in intra-ASEAN trade 2005 (%)

Brunei Darussalam	0.7
Cambodia	0.4
Indonesia	10.9
Laos	0.2
Malaysia	21.6
Myanmar	0.8
Philippines	5.3
Singapore	40.7
Thailand	14.9
Viet Nam	4.6

Source: Calculated from ASEAN Secretariat, External Trade Statistics, Table 18, <www.aseansec.org/18137.htm>.

³⁸ ASEAN Secretariat, 'Report of the Eminent Persons Group', paragraph 40.

These disparities suggest that, optimally, a system of weighted voting should be utilised in ASEAN's economic decision-making. Failing adoption of such mechanisms, and it would be an extremely unlikely development, a second best option would be to ensure, through the use of a system of qualified majority voting, that ASEAN's economically least important states do not have an effective veto over decision-making.

Other options have been put forward to attempt to facilitate more rapid integration through 'flexible participation' that involve a sub-grouping proceeding with measures while others remain on the sidelines. The two straightforward arrangements would be either an 'ASEAN - x ', or a '2 plus x ' procedure. Neither has much to recommend it. Whereas proponents suggest that undertakings by 'pathfinders' to pursue deeper integration may have a positive demonstration effect that convinces laggards to follow suit, an equally plausible argument is that enabling countries to opt out of various agreements removes the pressure on them to liberalise (as the WTO recognised in insisting that the Uruguay Round should be a 'single undertaking'). The fundamental problem with these types of arrangements is that they have the potential to institutionalise once again a multi-tier ASEAN with fragmented integration, which will continue to render ASEAN's integrative efforts of marginal interest to its target audience, private sector actors.

Beyond political will

ASEAN's failure to adopt binding obligations to deepen its economic integration is often attributed to 'lack of political will'. But for political economists, this should be the beginning rather than the end of an explanation—one has to explain why 'political will' was absent.

An absence of political will reflects the configuration of political forces within member states on issues relating to ASEAN integration. As Richard Stubbs and Etel Solingen have argued convincingly, internationalising forces have generally been in the ascendancy in ASEAN over the last two decades.³⁹ It is not that pro-liberalisation business groups oppose deeper ASEAN integration. Rather, it is that liberalisation under ASEAN auspices

³⁹ Richard Stubbs, 'Signing on to liberalization: AFTA and the politics of regional economic cooperation', *Pacific Review*, 13(2) 2000: 297–318; Etel Solingen, 'ASEAN, *quo vadis?* Domestic coalitions and regional co-operation', *Contemporary Southeast Asia*, 21(1) 1999: 30–53.

simply has not been of sufficient significance to warrant their expending substantial resources to lobby for deeper integration. Unilateral liberalisation, ASEAN members' participation in multilateral agreements such as the Information Technology Agreement, the creation of export processing zones or duty drawback arrangements together have substantially freed intra-regional trade in components and final products for many of ASEAN's most significant exports. As discussed earlier, these developments have at least partially undermined the case for an ASEAN FTA—the additional benefits that AFTA creates compared with the MFN tariff treatment frequently are negligible, particularly given the uncertainty caused by inconsistent implementation of state commitments. One can credibly make the argument that the supply of intra-ASEAN trade liberalisation has exceeded the demand for it.

Second, for the outward-oriented (and generally relatively small) economies of Southeast Asia, regional countries provide markets for a small percentage of overall output. The share of intra-regional trade in ASEAN's total trade has remained remarkably stable over the 40 years of ASEAN's existence (Table 5). Although this ratio is relatively high for FTAs among less developed economies (certainly much higher, for example, than those that link African states), it is still less than one-quarter of all of ASEAN's trade. The introduction of AFTA has not led to a marked increase in intra-regional trade in overall trade.

When there has been significant demand for further liberalisation within ASEAN, it has typically come from foreign corporations keen to rationalise their production on a regionwide basis. By far the best example is the automobile industry, especially Japanese car assemblers, which lobbied for ASEAN's Brand to Brand Complementarity programme (introduced 1988), and its subsequent improvement through the 1996 ASEAN Industrial Cooperation Scheme.⁴⁰ But this activism in support of intra-ASEAN liberalisation remains very much the exception. Given their extra-ASEAN export-orientation, and their dependence on imported components from their home countries, subsidiaries of foreign corporations are more likely to expend resources supporting liberalisation on an MFN basis or lobbying for

⁴⁰ Richard F. Doner, 'Japan in East Asia: Institutions and regional leadership', in Peter J. Katzenstein and Takashi Shiraiishi (eds), *Network power: Japan and Asia* (Ithaca: Cornell University Press, 1997), pp. 197–233.

PTAs with industrialised economies than they are on supporting intra-ASEAN liberalisation.

Table 5: Changes in the share of intra-regional trade in selected regional trade agreements (RTAs), 1970–2005

	1970	1980	1985	1990	1995	2000	2005
EU (1957)	59.5	60.8	59.2	65.9	62.4	65.7	65.7
NAFTA (1994)	36.0	33.6	43.9	41.4	41.5	46.4	42.9
MERCOSUR (1991)	9.4	11.6	5.5	8.9	19.2	20.4	15.7
ASEAN/AFTA (1992)	22.4	17.4	18.6	19	22.0	23.8	24.6

Note: Figures in parentheses refer to year in which the RTA came into force.

Source: WTO Secretariat, *World trade report 2003: South–south trade, trends in non-oil commodity markets and the growth of regional trade agreements* (Geneva: World Trade Organization, 2003), Table 1B.11, updated with author's calculations from data in WTO, *International Trade Statistics 2006*, Appendix Table A3, <www.wto.org/english/res_e/statis_e/its2006_e/its06_appendix_e.htm>.

The dominant position of subsidiaries of transnational corporations in export-oriented manufacturing raises other issues in the domestic political economies of ASEAN members. In Singapore and Malaysia, these subsidiaries are estimated to be responsible for more than 80 per cent of manufactured exports. This dependence on foreign subsidiaries affects trade politics in several ways. First, these subsidiaries often find it difficult to gain access to governments. Second, their prominent profile raises populist concerns that foreign corporations may be the principal beneficiaries of deeper ASEAN integration—hence the pointed reference in an Institute of Southeast Asian Studies (ISEAS) report on the ASEAN Economic Community to the need for it ‘to be made clear to the private sector that the AEC will not only benefit MNCs, but also ASEAN companies’.⁴¹

The emphasis that ASEAN has placed on responding to the needs of the private sector, notwithstanding, integration in the region remains a government-driven process in which business has little effective institutionalised representation. As the current Secretary-General of ASEAN

⁴¹ ISEAS, *Towards realizing an ASEAN community*, p. 14.

acknowledges, 'a perception lingers that the private sector has not been fully and actively involved in the integration and community building processes in ASEAN'.⁴² The ISEAS report notes that the institutionalisation of private sector representation in ASEAN through the ASEAN Chamber of Commerce and Industry, which was represented at meetings of Senior Economic Officials and Economic Ministers, was 'ineffective and disorganized'.⁴³

And while liberalising forces may have been in the ascendancy in ASEAN over the last two decades, what Solingen calls 'backlash coalitions'—essentially various representatives of the forces of economic nationalism—are by no means completely vanquished. Developments since the financial crisis in ASEAN's major economies have seen varying fortunes for these coalitions. In Indonesia, democratisation has reinforced economic liberalisation with the removal of the Soeharto-era monopolies. In Thailand, in contrast, Thaksin Shinawatra's administration reinforced the position of a new set of cronies while the subsequent military administration has pursued erratically various policies of economic nationalism. In Malaysia, despite the retirement of Dr Mahathir Mohamad, business as usual continues with clientelist networks continuing to be prominent. In short, 'backlash coalitions' continue to wield considerable influence, frequently protected by various non-tariff measures, in many of those areas where barriers to deeper integration remain—and their influence is not balanced by subsidiaries of foreign corporations primarily concerned with the extra-ASEAN dimensions of trade.

CONCLUSION

ASEAN enters its fifth decade in circumstances arguably more propitious than those prevailing at the time of its thirtieth anniversary celebrations. The region has recovered strongly from the financial crisis. Economic growth has been restored, even now in Indonesia, albeit at somewhat lower levels than achieved in the 1980s. Foreign direct investment inflows have revived, with record levels being recorded in 2005, the most recent year for which data are available. And Vietnam is rapidly emerging as a new ASEAN success story.

⁴² Ong Keng Yong, 'Challenges and prospects'.

⁴³ ISEAS, *Towards realizing an ASEAN community*, p. 14.

ASEAN, meanwhile, at least at the leadership level does appear to be heeding the lessons of previously ineffective cooperation. The commitment to an ASEAN Economic Community was a bold gesture, which if fully implemented would provide a foundation for ASEAN to more effectively address the new challenges it faces arising from the growth of China and India, and from the proliferation of preferential trade agreements. But nearly four years beyond pledging itself to the realisation of an economic community, scepticism is growing that the various 'roadmaps' that ASEAN has drafted will provide the stimulus required for deeper integration to be achieved.

Two dimensions are particularly important. One is the weak institutional foundations for ASEAN integration. Here, how the current debate on the ASEAN Charter is resolved will be crucial. Institutional reform will be a litmus test for whether ASEAN members have overcome their longstanding fear of making binding commitments. The other dimension is non-tariff barriers, which have yet to be addressed effectively. One of the most insightful commentators on ASEAN, and a sympathetic participant in the integration process, Hadi Soesastro, suggested that the core elements of the economic community must be put in place by 2010: 'failure to do so will make the exercise no longer meaningful'.⁴⁴ Even if the circumstances surrounding ASEAN's fortieth anniversary are more propitious than those of a decade ago, the coming years will be no less as significant a test of ASEAN's credibility and relevance.

⁴⁴ Hadi Soesastro, 'An ASEAN economic community and ASEAN+3: How do they fit together', Pacific Economic Papers 338 (Canberra: Australia-Japan Research Centre, Australian National University, 2003), p. 6.

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