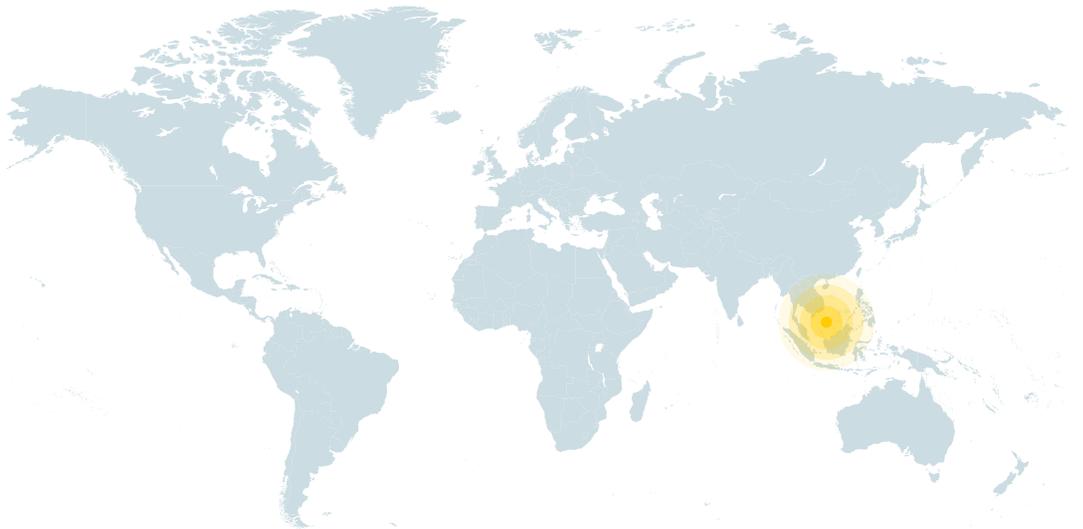


# Between Vision and Reality

Perception of the ASEAN Economic Community  
in Thailand, Cambodia and Indonesia

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On 22 November 2015, the ten member states of the Association of Southeast Asian Nations (ASEAN) decided to form an economic community. The integration process thus initiated might unleash further growth potential in the already dynamic region. However, whether a regional consciousness or even a common regional identity will develop in the process, remains to be seen.

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At the end of 2015, a new economic community came into being – initially at least by name – in one of the most dynamic regions of the world. By founding the ASEAN Economic Community (AEC), Brunei, Indonesia, Cambodia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam, with a total population of over 600 million and a combined economy ranking seventh in size worldwide, took a major step to create a common market for goods, services, investments and jobs in Southeast Asia. While this does not mean that the regional integration process has thereby been completed, the AEC will provide new impetus to the realisation of the undeniable potential offered by greater integration between the countries. According to estimates, the region will have a middle class comprising 400 million people by 2020 and, by simultaneously acting as a single manufacturing base and sales market, will become even more attractive to domestic and foreign investors through measures including the abolition of all customs duties and non-tariff trade barriers.

### **The ASEAN Way**

The Association of Southeast Asian Nations (ASEAN) looks back on a history of almost half a century. On 8 August 1967, Indonesia, Malaysia, the Philippines, Singapore and Thailand founded the organisation to further development in and cooperation between the member states in economic, social and cultural matters.<sup>1</sup> A further important objective was to make a contribution to security and stability in the region, which all the participating parties considered to be under threat above all from communist forces.

While discussions continue about the extent of what has actually been achieved under the auspices of ASEAN, and about the influence the organisation is in fact exerting on regional developments, the association has survived, regularly voicing new objectives – particularly following and prompted by the accession of new members (Brunei in 1984, Vietnam in 1995, Laos and Myanmar in 1997, Cambodia in 1999) – and making a name for itself as an actor and frame of reference for regional concerns in the areas of security and the economy, among others.

Subsequent to the end of the Vietnam War, the first ASEAN meeting at the level of the heads of state and government was held in 1976, at which the “ASEAN Concord” and the “Treaty of Amity & Cooperation in Southeast Asia” were adopted; recognition of the latter represents a condition for participating in the “East Asia Summit” (EAS) today.<sup>2</sup>

1994 saw the first meeting of the ASEAN Regional Forum (ARF),<sup>3</sup> then the first multilateral security policy forum in Asia, which has since been complemented by the ASEAN Defence Ministers Meeting (ADMM) and the ASEAN Maritime Forum (AMF).

Against the backdrop of the Asia-Pacific Economic Cooperation (APEC)<sup>4</sup> initiated by Australia with the backing of the USA, the idea of a purely Asian “Economic Caucus” emerged for representing the ideals and values specific to the region (ASEAN Way). Among other things, this produced a proposal, put forward in 1992 and finally realised in 2003, for the establishment



Summit: The AEC attracts international interest. This picture shows the heads of government of the ASEAN member states along with U.S. President Obama in California in February 2016. Source: © Kevin Lamarque, Reuters.

of the ASEAN free trade area, which took on a more concrete form following the end of the Asian financial crisis in 1997 with the initiation of the ASEAN+3<sup>5</sup> process and the Chiang Mai Initiative (CMI).<sup>6</sup>

At the turn of the millennium, the now ten ASEAN members announced the Initiative for ASEAN Integration (IAI), intended to counter the developmental disparities in the region and promote greater and deeper integration. At the 2003 ASEAN summit, ASEAN Concord II was adopted, which not only confirmed the original resolutions, but also announced the establishment of an ASEAN Community comprising three pillars: the ASEAN Economic Community (AEC), the ASEAN Political-Security Community (APSC) and the ASEAN Socio-Cultural Community (ASCC). We shall now take a closer look at the AEC, which soon attracted international attention.

### The ASEAN Economic Community

In 2007, on the occasion of the organisation's 40<sup>th</sup> anniversary, the so-called "AEC Blueprint" was adopted in Singapore in conjunction with the ASEAN Charter, defining the objectives of the Economic Community as follows:

„The AEC will establish ASEAN as a single market and production base, [which] shall comprise five core elements: (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) freer flow of capital; and (v) free flow of skilled labour.“<sup>7</sup>

In addition, the competitiveness of the region is to be increased by development and integration in the areas of competition policy, consumer protection, intellectual property rights, infrastructure, taxation and e-commerce. Measures to further the SME sector and specific steps to

assist with the integration of the economically weaker member states Cambodia, Laos, Myanmar and Vietnam (CLMV) are intended to help to close the developmental gap in those countries. Further objectives include a more coherent approach to handling foreign trade relations and better integration into global supply networks to help the member states integrate more effectively into the global economy.

### **The launch of the AEC must be considered as one more step in the process of integration and not its conclusion.**

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The AEC has now been launched officially. Assessments of the current state of affairs and prospects regarding the realisation of the ambitious objectives vary greatly, within and outside the region on the one hand, and between and within the individual member states on the other. However, even the most ardent supporters do not expect all the goals to be reached in full. In any case, it is more appropriate to consider the launch of the AEC as a step in the integration process and not its conclusion. Established ASEAN practice differs from the EU model, which did not lend much to its *modus operandi*, contrary to popular belief. Bowing to the principles of sovereignty and non-interference, economic integration in Southeast Asia has only ever been deemed appropriate in areas where it was undisputedly considered to be of benefit to all. Consequently, it has mostly been a case of gradual change, taking into account individual circumstances, rather than the prompt implementation of clearly defined sets of rules for all parties and strict provisions to enforce compliance.<sup>8</sup> But even when one takes into account these limitations, one is bound to have some doubt about the AEC achieving immediate success.

In Thailand, for instance, it is becoming increasingly obvious that structural reforms are urgently required to prepare large parts of the economy and population for the impending

intensification of regional competition through measures to raise the level of the country's currently inadequate competitiveness. This applies to an even greater extent to a country such as Cambodia, which is intent on becoming more attractive as a manufacturing base and an investment location on the one hand, which will require an upskilling of its labour force, yet simultaneously faces the challenge of limiting the exodus of this human capital to the more developed neighbouring states. In Indonesia, fuller realisation of the benefits of regional integration and an open economic policy would provide opportunities to revitalise the recently stagnating economic growth by measures to implement essential extensive reform projects.

#### **Thailand**

The political conflict, which has repeatedly led to bloody confrontation for a number of years, and the resulting political instability have increasingly pushed important economic topics down the political agenda in recent years. Public perception and media reporting have focused very strongly on the political conflict with the result that other important topics, such as the launch of the ASEAN Economic Community and the associated consequences, have not been afforded appropriate attention in these quarters either.

Relations between Thailand and the EU and the USA deteriorated after the military coup of 22 May 2014. It is now unlikely that a free trade agreement, which could bring about a significant improvement in economic cooperation, will be signed between the EU and a Thai government that lacks democratic legitimacy.<sup>9</sup> In addition, economic growth has been impacted strongly over the last two years, particularly by the political unrest. After growth had not even reached one per cent in 2014, fears grew that Thailand would not even achieve the forecast of three per cent in 2015, which the Bank of Thailand had already downgraded several times.<sup>10</sup> One of the reasons is the fact that Thailand's exports had fallen for five consecutive months since the beginning of 2015.<sup>11</sup>

This illustrates that the Thai economy urgently requires new impulses for growth and that it will have to open up new markets to return to adequate growth as soon as possible. The launch of the AEC is an important occasion for revitalising Thailand's ailing economy, particularly given the current situation.

In Thailand, which was never colonised and was therefore frequently isolated from foreign influences, public attention is increasingly being directed to the neighbouring countries. It has become possible for the well-off middle class, which has been emerging over the last few decades, to travel to other ASEAN countries on holiday and thus get to know them. Thailand has also changed from a recipient of foreign aid to a donor country in recent years. It is increasingly becoming involved in development programs in poorer ASEAN countries,<sup>12</sup> which in turn increases public attention and interest in the living conditions in these countries and in cooperation with them.

#### *Free Movement of Goods and Services*

Due to the introduction of the minimum wage in Thailand in 2013, wages rose in some industry sectors. As a result, some parts of labour-intensive production in poorer and less-developed ASEAN countries have become significantly more price-competitive. Agriculture in particular is currently struggling with comparatively high costs and low productivity. While farmers in Vietnam produce 862.4 kilograms of rice per *rai*,<sup>13</sup> for instance, the yield in Thailand is only 448 kilograms.<sup>14</sup> Due to such large differences, it is likely that people with a low standard of education and those working in agriculture in Thailand in particular will face massive problems by the stronger competition resulting from the launch of the AEC.<sup>15</sup> While there are still some exceptions for a number of agricultural products, the AEC will not be able to avoid abolishing such exceptions in the medium or long run.

This example shows that, on the one hand, Thailand will have to conduct far-reaching structural

reforms, and particularly a reform of the education system, in order to take advantage of the opportunities offered by the AEC. Otherwise, the launch of the AEC will result in unproductive industries collapsing and unemployment rising if the Thai economy does not succeed in rising to a higher level in the value chain, enabling it to compensate for higher production costs through improved productivity.

On the other hand, there are, of course, many industries that can benefit massively from the opening up of markets and from economic integration. Through the further development and fostering of highly-developed manufacturing and service industries, Thailand could succeed in taking the final step in its transition from an emerging economy to an industrialised country. Thailand is, for instance, already one of the world's most popular medical tourism destinations due to relative low costs and high medical standards. The health sector in particular is therefore expected to benefit from the AEC and the anticipated associated economic growth in the region as well as from the free movement of people. That said, the boom in private hospitals has already resulted in a shortage of doctors at public hospitals, where salaries are lower. As Thai society is also set to age considerably over the next few decades, urgent efforts will have to be made to improve the training of doctors and nurses in Thailand and to simplify the recognition of foreign qualifications.<sup>16</sup> As this further example shows, the AEC may entail numerous opportunities for Thailand, but first, political decisions will need to be taken urgently to minimise the risks and to implement the necessary adaptation processes and reforms.

#### *Investment Freedom*

Over the last few decades, Thailand has managed the transition from an agricultural state to an upper-middle income country<sup>17</sup> in impressive style and made substantial improvements in important areas such as economic output and access to social services. While as many as 82.5 per cent of the labour force were still engaged in agriculture in 1960, the figure had dropped



Protest: A young protester covers his head with a plastic bag to protect himself from the police's tear gas. Thailand's year-long political unrest is taking a serious toll on the country's economy. Source: © Damir Sagolj, Reuters.

by over half to 40 per cent by 2000.<sup>18</sup> Although vehicle production experienced a significant year-on-year reduction of 23.5 per cent, Thailand still manufactured 1.88 million units in 2014, exceeding output in France.<sup>19</sup> However, Thailand has not always attracted investment in future technologies in the desired volume in recent years. The country was at the bottom of the economic growth ranking in the ASEAN region in 2015 and is likely to remain there for several years to come.<sup>20</sup>

Consequently, new investment is urgently required in Thailand, particularly in future technologies and in growth sectors. This illustrates how important the AEC and the associated improvements for investment, trade and the free movement of workers currently are for Thailand's future economic development. With new investment in other ASEAN countries, the Thai economy will be able to expand its pro-

duction networks and thereby improve its own competitiveness. The free movement of capital that the launch of the AEC entails will facilitate this development considerably. The longer the economic stagnation that began with the political unrest in 2014 will last, the stronger public awareness of the need for new investment and modernisation in the Thai economy will become.

#### *Free Movement of Workers*

According to official statistics, there is virtually no unemployment in Thailand. The official unemployment rate for 2013 was just 0.7 per cent, the same as in the previous two years.<sup>21</sup> In this scenario, the freedom of movement for skilled workers under the rules of the AEC can help to alleviate the skills shortage that has been impeding economic growth to date. There are currently already an estimated two to three mil-

lion migrant workers from neighbouring Myanmar, Laos and Cambodia in Thailand, albeit in many cases lacking official status and a valid residence permit.<sup>22</sup> The launch of the AEC entails extensive legalisation of labour migration for skilled workers, which should result in Thailand's unemployment rate coming more into line with that of other ASEAN countries, leading to greater supply and competition in the Thai labour market.

Reforms are required particularly urgently in the education sector, where the consistent implementation of reform measures has proved difficult in recent years because of the political instability. Both the Thai school system and the university system came relatively low in the rankings of a number of international comparisons.<sup>23</sup> There is consequently an urgent need for reforms to equip Thai school-leavers and graduates for the ASEAN labour market, where they will be up against very strong competition. It is also important for Thailand as a provider of tertiary education to have good universities to attract students from other ASEAN states. If good students and academics from Thailand were to move to other ASEAN countries without a sufficient flow in the opposite direction, this would pose great problems for Thai universities, which will suffer from the coming demographic changes in any case.

### **There is a tangible scepticism among the Thai population regarding the question if the country is well prepared for the AEC.**

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As the launch deadline for the AEC approached, public attention increasingly also turned to the potential disadvantages and risks involved. In a survey conducted by the Bangkok Post newspaper in January 2015, only 5.2 per cent of respondents stated that Thais were well prepared for the AEC. 94.8 per cent thought that

Thais were nowhere near ready.<sup>24</sup> While this was only a non-representative survey of just under 2000 people, the results indicate that scepticism towards the AEC among the Thai population was increasing as the launch deadline was approaching and people were becoming more aware of the concrete implications. At an event in Bangkok back in December 2014, Finance Minister Sommai Phasee had already stated that Thailand was not ready for the AEC and that many regulations still needed to be amended and adapted.<sup>25</sup> At the same event, Yu Jienyoenyongpong, Chairman of the Land Transportation Federation of Thailand, stated that Thailand's willingness to begin engaging in the AEC by the end of the following year would depend on the readiness of the small and medium-sized enterprises (SMEs). In his view, SMEs, which make up 90 per cent of Thailand's businesses, were not yet ready because they lacked the necessary knowledge and financial resources.<sup>26</sup>

#### *Interim Conclusion: Thailand*

Thailand can only overcome the current weakness in economic growth through structural changes and further economic integration. These are also the requisites for Thailand's rise from being an emerging economy to joining the group of industrialised countries. For a country that is already highly economically advanced by comparison with its regional partners, the AEC offers excellent opportunities for taking measures to increase efficiency and improve competitiveness in the country while helping to alleviate the skills shortage. On the other hand, the launch of the AEC means that industries that are already uncompetitive will – together with large numbers of low-skilled workers – come under even greater pressure. The accelerated structural changes, which are urgently required for Thailand's future development, would entail further problems in the short and medium run. They would, in particular, result in greater unemployment or underemployment among the low-skilled, and the stronger competition would mean that unproductive companies and industries would either close down or become

reliant on state handouts. This could initially exacerbate social tensions and potentially also the associated political tensions in Thailand even further. However, political stability and a social consensus about necessary reforms and the improvement of the education system are required to convert the challenges the AEC entails into concrete opportunities for Thailand.

However, once the economic challenges and adjustment processes have been mastered, there will be huge potential for the Thai economy. China<sup>27</sup> and Russia,<sup>28</sup> for instance, have already worked intensively on strengthening their economic links with Thailand over recent months, including visits by some high-ranking political delegations. An essay published by the bpb, the German Federal Agency for Civic Education, described ASEAN, whose combined annual GDP in excess of 2.3 trillion U.S. dollars even exceeds India's economic power, as "the ignored giant" due to the lack of attention it had attracted.<sup>29</sup> The Russian Industry and Trade Minister Denis Manturov made the following remark while accompanying Russian Prime Minister Dmitry Medvedev on an official visit in April 2015: "Our friends from the Western part of the world are ignoring Thailand."<sup>30</sup> But one can probably hope and expect that the economic potential of the ASEAN region will be afforded greater attention by Germany and Europe in the future.

## Cambodia

Cambodia is one of the CLMV countries.<sup>31</sup> Consequently, it is being granted longer transition periods for implementing the decisions taken by the ASEAN states. Hopes for an economic upturn in Cambodia associated with the "AEC Blueprint" are countered by justified fears of Cambodian small farmers, SMEs and the aspiring younger generation of not being able to withstand the competitive pressures the integration process will entail.<sup>32</sup> Consequently, large parts of the Cambodian population are developing an ambivalent stance towards the AEC, wavering between confidence and scepticism. This ambivalence is clearly evident, particularly with respect to the free movement of goods

and services, investment freedom and the free movement of workers, which are all key components of the integration process.

### *Free Movement of Goods and Services*

Illustrating the hopes that many Cambodians associate with the "AEC Blueprint", Sok Siphana, Head of the Cambodia Development Research Institute, speaks of the deepening of the ASEAN Community representing a "golden opportunity" for Cambodia.<sup>33</sup> This level of confidence is encouraged by three developments that are becoming apparent.





The gloves are off: Cambodia's agricultural sector is to remain protected from international competition by ASEAN states until the year 2018. In Cambodia, almost every other gainfully employed person is working in the agricultural sector. Source: © Pring Samrang, Reuters.

Under AEC rules, Cambodia was due to abolish all import duties by the end of 2015. However, the CLMV states were granted a period of grace for so-called sensitive products, which means that they will not have to abolish the associated import duties until the end of 2018.<sup>34</sup> Proponents of the AEC make reference to this special arrangement in their efforts to dispel concerns about a premature opening up of Cambodia's labour and goods market, pointing out that the agricultural sector will therefore still be protected against competition from other ASEAN states to a large extent until 2018. While import duties will have to be reduced gradually in

this sector as well, they argue that it will take a customs reform introduced throughout the AEC region to improve trade controls through enhanced data exchange between the ASEAN states, to simplify cross-border trade and to ultimately put Cambodia's trade balance permanently on a new footing.<sup>35</sup>

Cambodia's export industry is limited to a small number of sectors and categories of goods. Textiles and shoes make up 82 per cent of total exports.<sup>36</sup> Due to the low level of diversification, the Cambodian economy is very vulnerable to fluctuations in global demand and to external

influences. That said, the World Bank had forecast a GDP increase of 6.9 per cent for 2015 and 2016.<sup>37</sup> The intensified integration of regional and global supply chains, a significantly larger goods market and diversification in the manufacturing sector, which the AEC is expected to bring about in Cambodia, are boosting confidence further.

Cambodia's exports to other ASEAN countries also have growth potential. The country is currently still highly dependent on the demand for textiles from the USA, Canada, Europe and Hong Kong.<sup>38</sup> In 2013, for instance, the export of these products to ASEAN member states constituted a mere eight per cent of total exports in terms of value according to official figures.<sup>39</sup> The lowering of the trade barriers between the individual member states associated with the implementation of the "AEC Blueprint" now offers Cambodia the opportunity to also increase its exports within the ASEAN Community. In view of this long-term positive impact of a further liberalisation of trade and the country's significant geographic location, Hidetoshi Nishimura, Head of the Economic Research Institute for ASEAN and East Asia, even considers it "impossible" for Cambodia not to benefit from the region's economic upturn.<sup>40</sup>

But not all Cambodians appear to share this confidence. According to statistics from the Asian Development Bank, 55 per cent of SMEs, which represent the traditional backbone of the Cambodian economy, were still not fully aware of ASEAN's plans for deeper integration, let alone the economic implications, by the end of 2013.<sup>41</sup> To obtain any benefit from the AEC and adapt their business models accordingly, it is essential for local and regional companies to begin taking proactive steps early on to ready themselves for the increasing competitive pressures the introduction of the AEC will inevitably entail.<sup>42</sup>

The agricultural sector in particular, which produces the second-largest proportion of GDP and employs almost 51 per cent of the labour force, will need some support from the government, at

least temporarily.<sup>43</sup> Without such support, Cambodia's small-scale farmers, who tend to lack the necessary capital to buy modern machinery and high-yield seed as well as know-how about efficient farming methods, will lose out in the competition with farmers in other ASEAN states in the long term.

Where the important secondary sector is concerned, government experts themselves, such as representatives from the Ministry of Industry, Mines and Energy, have also had to concede that Cambodia's producers cannot compete with the products of other ASEAN countries on price or quality.<sup>44</sup> Because of the underdeveloped physical and HR infrastructures, the people employed in the manufacturing industry (some 20 per cent of the total labour force) will not be able to take full advantage of the sector's economic potential.<sup>45</sup> High energy costs, a poorly developed transport network and very limited Internet access, particularly in rural areas, make for high production costs, which low labour costs can only compensate for to a limited extent.<sup>46</sup>

However, instead of taking concrete measures to strengthen the competitiveness of SMEs so that they can meet international production standards and thereby compete with businesses in other ASEAN states in the future, the government is delaying overdue reforms, such as simplified and consistent tax legislation and a lessening of red tape involved in the purchase of urgently required machinery.<sup>47</sup> Instead, Cambodian SME owners are apparently being fobbed off with vague promises of "power connectivity" and production networks evolving as a result of the deepening of the ASEAN Community.<sup>48</sup> Heng Heang, president of the Phnom Penh Small and Medium Industries Association, has warned that in the absence of concrete reforms to improve the economic framework many local entrepreneurs have a very critical view of the AEC.<sup>49</sup> He believes that many SMEs have concerns about Cambodian industries being displaced and about the loss of identity this would entail, which need to be taken seriously.





Night camp: Working conditions in Cambodia's textile industry are abhorrent. This woman is sleeping with her child in a warehouse near Phnom Penh. Source: © Damir Sagolj, Reuters.

### *Investment Freedom*

Over the last few years, Cambodia has developed into an attractive investment location. Particularly the energy and construction sectors have attracted investments on a large scale, with the People's Republic of China being the largest investor with a combined investment volume of 8.8 billion U.S. dollars in 2015.<sup>50</sup> But there is potential for increases in the investment volumes of other ASEAN states, particularly in the areas of agriculture, food processing, tourism and construction. In the World Bank "Doing Business Report", Cambodia is only ranked 135<sup>th</sup>, lagging behind its neighbours in most categories.<sup>51</sup>

As the Blueprint harmonises the legal framework for investors within ASEAN further and the government has already implemented some,

partly quite successful reforms in the course of the integration process, further increases in direct investment are to be expected. The measures have included tax concessions for foreign investors, more effective methods to clamp down on tax evaders<sup>52</sup> and an online "one-stop shop", which should, among other things, cut red tape and make it easier for businesses to register. Government efforts to increase transparency and create a fair competitive environment have been welcomed by investors and are helping to enhance the perception of the "AEC Blueprint".

### *Free Movement of Workers*

With the opening up of the labour market, jobs in Cambodia are now also becoming accessible to foreign workers. There are some 150,000 vacancies in the clothing industry, for instance.<sup>53</sup>

English-speaking personnel as well as technical experts are among the most sought after. As few people of working age are moving abroad, the hope in Cambodia is that the AEC will help to close this gap.<sup>54</sup> Cambodia's influential hotel and restaurant umbrella organisations welcomed the launch of the AEC at the end of 2015.<sup>55</sup> As one of the country's economic mainstays, particularly the tourism sector hopes that the inward movement of skilled workers will help it to quickly close the existing vacancies.

The Ministry of Labour has pointed out that both the rising numbers of foreign workers and especially the experience gained by Cambodians working abroad facilitate the transfer of knowledge and thereby benefit Cambodia as well.<sup>56</sup> The AEC thereby offers opportunities for improving the competitiveness of skilled staff trained in Cambodia and of the goods produced in the country.

### **Free movement of workers shall help to fill job vacancies in some industries.**

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However, the concerns and fears for the future, which the integration process evokes particularly among the young, qualified generation, indicate that the expectations of the AEC in Cambodia are also ambivalent where the newly enshrined free movement of workers is concerned, specifically for skilled personnel in certain sectors.

The first question is whether the implementation of the AEC alone can stimulate the hoped-for migration of labour to Cambodia. According to Chuop Narath, a high-ranking Labour Ministry official, the country currently has limited appeal for qualified job seekers from other ASEAN countries, particularly due to the relatively low pay rates compared to neighbouring countries such as Singapore and Malaysia.<sup>57</sup> To prevent a mass brain drain and ensure that the country can stand its ground in the battle for

skilled manpower, Prime Minister Hun Sen has therefore called for pay increases in the private sector.<sup>58</sup> But this call will probably meet with a lukewarm response from the employers.<sup>59</sup> The prospect of lengthy rounds of negotiation with workers' representatives or even costly strikes may severely dampen the enthusiasm for the AEC among many employers. This stance could be strengthened further as such problems would mean that Cambodia's membership of the AEC would have a double impact on SMEs. The necessary pay adjustments would make investment for lowering production costs or increasing product quality more difficult.

While the free movement of workers promoted by the AEC may well have a positive impact on the Cambodian labour market, further major efforts are required, particularly where the development of efficient, decentralised vocational education systems are concerned, to cover the high national demand for well-qualified specialists.<sup>60</sup> There is also work required in the tertiary education sector to close the gap in educational standards. Most graduates from Cambodian universities are currently still finding it difficult to have their qualifications recognised abroad. Lower education standards at universities, persistent corruption in the education system, where connections are frequently more important than performance for people to get ahead, are putting Cambodian graduates at a disadvantage.<sup>61</sup> It appears that the country's young educational elite shares the fear of not being able to match the better-trained competition in the regional labour market.<sup>62</sup>

#### *Interim Conclusion: Cambodia*

As a neighbour of Thailand and the even more populous Vietnam, with a combined population of close to 200 million, and enjoying a strategic position at the heart of the ASEAN region with access to the sea, Cambodia too has great potential for economic growth through increased economic integration. The dividends of increasing integration can already be seen in the stable economic growth with consistently low inflation over the last ten years. One can

therefore assume that Cambodia will be able to continue increasing its most important exports (tourism, agricultural products, textiles) to the ASEAN countries. Compared to its neighbours, Cambodia is becoming increasingly attractive for foreign direct investment, although there are still some deficiencies in the areas of legal certainty for businesses, investment protection and the fight against corruption. This is not, though, deterring investors, particularly those from China.

However, due to its dependence on exports and the still low level of diversification of its economic base, the country remains vulnerable to external demand shocks. And the increasingly noticeable effects of climate change on Cambodia's agricultural sector represent a further risk whose financial impact is difficult to foresee. The slow pace of physical infrastructure development (expansion of the national grid, the road network and the irrigation systems) and the delays in establishing a vocational education system aligned with the requirements of regional labour markets as well as the fact that energy costs are currently still very high compared to neighbouring countries will continue to weaken the country's competitiveness for some time to come. Integrating the high numbers of young among the population into the labour market over coming years will remain a major challenge for the government. If job prospects for the young appear bleak, the movement of low-skilled workers into the economically stronger neighbouring countries will increase further.

Cambodia will be affected by the AEC in a number of ways. The positive or negative perception of the economic integration process will be enhanced once the first winners and losers emerge. The media, civil society and interest groups will have to make greater efforts to perform their role of watchdog and act as critically analytical supporters and observers of the process. If they do, this will boost the realisation that decisions made by the ASEAN states have a direct impact on the lives of the Cambodian people.

## Indonesia

Indonesia is by far the largest economy in South-east Asia. And the world's largest island nation with a population of 250 million is also the region's only country represented in the G20. According to estimates, the Indonesian economy is to become the world's seventh or fifth largest economy, depending on the source, by 2030. Nevertheless, Indonesia is facing great economic challenges. Instead of the seven per cent the government forecast for the period to 2018, growth fell to 4.7 per cent in 2015. Share prices and exchange rates were also occasionally weaker than at any time since 1998. In addition to external factors (raw material prices/China's economic development, U.S. interest policy), this was put down above all to the government's reluctance to take prompt action. The new government team that took up its work as the so-called "Working Cabinet" appeared increasingly incapable of action. On 12 August 2015, just ten months after taking office, the head of state and government Joko Widodo felt forced to conduct his first cabinet reshuffle.<sup>63</sup> Since then, Indonesia has made efforts to reverse the trend and generate new impulses for growth by means of a number of partly promising reform packages. If Indonesia is successful in creating the right conditions, the launch of the AEC can make an important contribution. A simulation-based study of GDP development for the period up to 2030 conducted by Singapore Management University even named Indonesia the potentially largest absolute winner from the introduction of the AEC.<sup>64</sup>

### *Free Movement of Goods and Services*

Despite the Asian financial crisis of 1997/1998, regional trade within the ASEAN area almost doubled in the period from 1993 to 2003 by over 400 billion U.S. dollars to over 800 billion U.S. dollars; and it has since tripled again to almost two-and-a-half trillion U.S. dollars. Especially for Indonesia, trade with and exports to ASEAN countries in particular are gaining increasingly in importance. In 2012, they accounted for over 20 per cent of Indonesia's



Reform bottleneck: Indonesia has the largest economy in Southeast Asia. The country is now facing major economic challenges, as economic growth in 2015 is expected to be lower than had been initially predicted. Source: © Beawiharta Beawiharta, Reuters.

entire exports, totalling over 40 billion U.S. dollars; in 1996, before the Asia crisis, it had been just 7.5 billion U.S. dollars. The potential of a common market in Southeast Asia with a combined GDP of approximately 2.5 trillion U.S. dollars therefore does not appear to have been exhausted yet by any means.<sup>65</sup>

Indonesian entrepreneurs have already recognised this potential and consider the AEC's beginning mainly as an opportunity. The CEO

of the Indonesian Lippo Group, James T. Riady, spoke enthusiastically of the AEC at this year's World Economic Forum Annual Meeting, referring to it as "the beginning of something quite fantastic".<sup>66</sup> He further argued that the ASEAN common market would particularly benefit the services sector. A view shared by Suryo Bambang Sulisto, Chairman of the Indonesian Chamber of Commerce and Industry (Kadin), who added that "the ASEAN Free Trade is not a threat but a big opportunity".<sup>67</sup> At this year's



annual general meeting of the Association of the Indonesian Young Entrepreneurs (HIPMI), the organisation's chairman Raja Sapta Oktohari also expressed optimism about the AEC bringing huge benefits for growth in Indonesia.<sup>68</sup>

However, among the countries of the region, Indonesia maintains the most restrictive non-tariff trade barriers, adding some 30 per cent to import costs. Also, customs clearing in Jakarta takes longer than in any other regional

port.<sup>69</sup> Many Indonesian businesses have very slight profit margins, which may ultimately prove to be inadequate in the new competitive environment and see them being forced out of the market. No doubt these vulnerable businesses include some of the 139 (!) state enterprises, which have enjoyed special protection from competition in the past.<sup>70</sup>

### *Freedom of Investment*

Indonesia's huge population of a quarter of a billion people is considered one of the country's great strengths. Particularly in view of the average age being below 30 and the forecast that the so-called "demographic dividend" will reach its zenith in the period from 2020 to 2030,<sup>71</sup> the Indonesian market already appears extraordinarily attractive. The attraction of a common Southeast Asian free trade area is even greater, and further enhanced by existing and impending free trade agreements with countries such as China, India, Japan, South Korea, Australia and New Zealand. Correspondingly, foreign direct investment in the ASEAN area has grown by a factor of six since 2000 to almost 120 billion U.S. dollars; among the member states, total investments grew even more strongly from under one billion to over 26 billion U.S. dollars. Singapore and Indonesia alone have jointly benefited from over 80 per cent of these investments.<sup>72</sup> The incentives to invest in Indonesia have been enhanced above all by the country's political stability, particularly compared to its regional partners, and the positive democratic developments since the end of the authoritarian Suharto era. Operating within the AEC, many businesses are planning to further increase their production capacities in Indonesia significantly, which will strengthen the country's role as a hub in the regional network.<sup>73</sup> The World Bank estimates that overall foreign direct investments in the ASEAN region will increase by up to 63 per cent as a result of the implementation of the AEC.<sup>74</sup> Japan, for example, the largest foreign investor in the region, already increased its funds by 120 per cent (!) to 23.6 billion in 2013, while reducing its investments in China to approximately



A new kind of living: Populous Indonesia has many incentives for foreign investment. This billboard from the year 2013 promoted luxurious apartments in Jakarta. Source: © Beawiharta Beawiharta, Reuters.

nine billion. Many German businesses have also expressed their intention to expand their engagement in the ASEAN region.<sup>75</sup>

To secure its share of these future investments, Indonesia will have to improve some trading conditions. Pervasive corruption, inefficient bureaucracy and a disastrous infrastructure in particular do not only pose enormous challenges to potential investors. According to Dr. Firdaus Alamsjah, Executive Dean of Binus Business School in Jakarta, Indonesia's infrastructure is the worst in the region, costing the country a quarter of its GDP.<sup>76</sup> Upon taking office, President Joko Widodo abolished fuel subsidies in a much-noted act of decisiveness; these had previously constituted almost a fifth of state expenditure. The government's intention was and still is to use the freed resources predominantly for upgrading roads, ports and power grids, and the latest economic reform packages indeed focused public investments on

these areas. It therefore appears that this huge challenge has at least been placed at the very top of the agenda.

#### *Free Movement of Workers*

Besides the physical infrastructure, the public education system and skills training also face great challenges. In a speech he held on 14 August 2015, Indonesia's President Widodo himself stated that educational standards were (still) too low and that by February 2014 over 75 million and therefore almost two-thirds of the some 120 million Indonesian workers had at best completed middle school. Low-skilled or unskilled workers will definitely not be among the winners of the implementation of the AEC in Indonesia either.

Just short of two months later, on 9 October 2015, the so-called Manpower Conference took place in Bogor, not far from the Indonesian

capital Jakarta. There, Indonesia's Manpower Minister, M. Hanif Dhakiri, expressed his conviction that the country's human resources were adequately prepared to survive in the regional competition. Tellingly, he presented a package of measures for the introduction of new qualification and certification standards in twelve of the economic sectors prioritised by the government at the same event, aimed at further enhancing this competitive readiness. The minister also confirmed that the ministry had initiated training centers to be set up throughout the country in order to prepare Indonesian workers even better for competing with foreign workers looking for the same jobs.<sup>77</sup>

#### *Interim Conclusion: Indonesia*

For Indonesia as well and in particular, the potential benefits of greater regional integration through the successful introduction and implementation of the AEC are obvious and are regularly confirmed by various parties. However, particularly during the first year of President Joko Widodo's term in office, growing protectionism raised increasing doubts in the country about the government's enthusiasm for further implementation of the Economic Community. However, the cabinet reshuffle in August 2015 and the announcement of packages of economic policy measures, which will inevitably need to involve genuine structural reforms as well, have raised hopes that the necessary change of course will happen. But should Indonesia effectively become mired in short-sighted self-obsession, this may not only have a negative impact on the country's development, but derail the entire regional integration project.<sup>78</sup>

#### **Conclusion**

To be successful, an integration process needs to entail shared ambitions and common guidelines on how to achieve agreed objectives. It appears that this has been achieved in Southeast Asia with the IAI, the "ASEAN Charter" and the "AEC Blueprint". What is less clear is whether all those involved and particularly the populations share a regional awareness or even the begin-

nings of a common regional identity as a further criterion. Nonetheless, the potential economic and political benefits make the Economic Community and the establishment of the ASEAN Community besides the other two pillars appear to be rational and opportune.

Recognition of these potentials within the individual countries will determine the success of the AEC; after all, it is not only in democratic countries that the way foreign relations are conducted is a result of internal conflicts and compromises between the different political and society actors. Regional integration cannot succeed without influential advocates and effective majorities in the member states, let alone against organised and powerful opposition.<sup>79</sup> But if it is possible to win over these crucial majorities, further economic integration would bear great potential in Southeast Asia as well.

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- 2 Summit meeting, which is attended by Australia, China, India, Japan, New Zealand and South Korea (ASEAN+6), plus Russia and the USA since 2011, in addition to the ASEAN states.
- 3 In addition to the ASEAN+6 states plus Russia and the USA, the parties involved in the ARF include Bangladesh, the EU, Canada, Mongolia, North Korea, Pakistan, Papua New Guinea, Sri Lanka and Timor-Leste.
- 4 Besides the ASEAN states, Australia, China, Japan, New Zealand and South Korea (ASEAN+6 excluding India) plus the USA and Russia, APEC meetings are also attended by representatives from Chile, Hong Kong, Canada, Mexico, Papua New Guinea, Peru and Taiwan. APEC's declared aim is to further free trade.
- 5 ASEAN members, China, Japan and South Korea.
- 6 In response to the Asian financial crisis, the ASEAN+3 states made a decision at a meeting held at the Asian Development Bank (ADB) in Chiang Mai in May 2000 to set up a number of bilateral currency reserves and ultimately a multilateral one intended to prevent a repetition of catastrophic liquidity problems that may trigger another financial crisis.
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