ASEAN Economic Community: The beginning, not the end

Author: Patrick Bessler, Berlin

The ASEAN Economic Community was launched at the end of 2015. It is set to transform the ASEAN region into a free trade area. The aim is not only to keep pace with current mega-regional free trade agreements such as the TPP and TTIP, but also to play an active part in shaping the future and become a hub for global trade. It looks unlikely that the objectives originally set for the launch date will now be met, and the loose confederation of states still faces huge challenges. However, what has been achieved to date should definitely still be seen as a success, not only from an ASEAN perspective. Whether the "ASEAN way" and what is ultimately a common market can be brought into harmony remains to be seen.

There have been many comparisons between the Association of Southeast Asian Nations (ASEAN) and the EU – whereby the former was always considered something of a failure. This should perhaps not come as a surprise, as ASEAN clearly copied many structures directly from the European Union without ever having reached anywhere near the same degree of institutionalisation. However, all such comparisons struggle from the outset, as this deep level of institutionalisation was never actually an objective. The principles of non-intervention and flexibility, central components of the self-chosen so-called "ASEAN way", are too important to the ten member states.

Yet with the ASEAN Economic Community, the nations of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam are planning a free trade area that could stretch far enough to at least justify a glance towards Europe. Tolls and non-tariff trade barriers (NTTBs) are to be removed, while intra-regional communication, investments and freedom are to be increased and standards harmonised. The focus is on global competitiveness and attractiveness as a location for foreign companies. The focus is on developing the local economy and infrastructure. The focus is on foreign direct investment (FDI). In short, the focus is on an economic area with around 620 million people, representing a large part of what is currently the most dynamic economic region in the world with total economic output of just under USD 2.6 trillion. A region in which multinational companies are creating increasingly complex added value chains that stretch along the Mekong, crossing multiple national borders. In low-wage countries such as Laos, labour intensive components are produced for assembly overseas, for example in Thailand. This is a region that, at the same time, is becoming an increasingly popular alternative to China.

Foreign direct investment in the ASEAN region reflects this. Between 2005 and 2015, total investment increased from around USD 38 billion to USD 136.2 billion, gaining around 13% in the period between 2012 and 2014 alone. With its emerging middle class population, it is also a region that is becoming increasingly important as a sales market, for example for international vehicle manufacturers. According to the ASEAN Automotive Federation (AAF), more than 3.5 million passenger vehicles are sold there every year. Around 4.4 million vehicles are produced in the most important countries of Indonesia, Thailand, the Philippines and Malaysia alone.

However: The member states of this area are highly heterogeneous in terms of their stage of development, political stability and culture. This not only requires close cooperation among all members, but eventually – if any lessons are to be learned from the EU – also suitable mechanisms to allow implementation of all jointly approved measures to be both monitored and guaranteed.

So, can ASEAN, the loose confederation of states, achieve this?

Probably not. At least not by the end of 2015/start of 2016, when the AEC is set to officially launch. Although almost all customs duties in the ASEAN region will have been removed by that time, a common market with free trade will still be a long way off.

Yet this does not represent the end of the economic community, only the beginning.

Four pillars for the common market

Strictly speaking, the first few steps of the ambitious treaty were taken some twenty years ago. At the 1997 summit meeting, also held in Kuala Lumpur, the member states decided to transform ASEAN into a stable, competitive and economically balanced region. The ASEAN Vision 2020 drawn up back then was subsequently developed further in 2003. It was from this that the ASEAN Economic Community first came into being at the community summit in Bali. The goal was for an extensive established economic community to become a reality by 2020. Another four years later, the ten member states had drafted the so-called AEC Blueprint, their masterplan for the long road toward harmonisation of all economic activities in the region. The AEC, to be launched at the start of 2016, is intended to establish the foundations for unity by 2020, together with the ASEAN Security Community and the ASEAN Socio-Cultural Community.

The common economic area rests on four pillars: Its intention is to create a common market and production location, promote the competitiveness of the economic region, ensure balanced economic development for its member states, as well as their integration into the global economy. Among other things, this means freedom of movement in terms of goods, investments and skilled labour, self-help, closer consultation regarding macroeconomic and financial policy, as well as closer networking through infrastructure and communication.

The masterplan for the AEC involved all non-tariff trade barriers being removed for the five ASEAN countries of Malaysia, Indonesia, Thailand, Singapore and Brunei by 2010, for the Philippines by 2012 and for the CMLV states of Cambodia, Laos, Myanmar and Vietnam by 2015 (potentially with good-will extension to 2018).

Massive differences between the states in some cases

The various targets already provide an indication of the region's highly heterogeneous nature. Singapore is a highly developed city state with a per capita GDP of almost USD 50,000. The CMLV states have just completed the transition from developing to emerging economies and are assuming the role of the region's new low-wage countries. Thailand and Indonesia have already completed this stage and permanently established themselves as production bases for overseas industrial enterprises, with which goods with greater added value can also be produced. Cambodia and Laos currently rank among the most popular destinations for FDI, although the two countries together only have 20 million residents and a GDP of USD 22 billion. With a population just three and half times larger, Thailand generates an economic output that is seven times greater than this. Brunei relies on oil, Singapore invests in trade, Indonesia builds on industry and Vietnam focuses primarily on agriculture. Myanmar has only just returned to the economic and political map. Although the differences in terms of infrastructure have been reduced, there is still a very long to go in some areas.

To equalise these would require annual investment of around USD 60 billion up to 2022, as calculated by corporate consultancy firm KPMG. According to the Global Competitiveness Index 2014-2015 of the World Economic Forum, Singapore is the world's second most competitive location. Thailand is in 31st place, Malaysia in 34th, Vietnam in 86th and Myanmar in 134th place. However, one thing that almost all of these states have in common is that they are continuously climbing further up these rankings each year.

Successes recorded to date...

All member states are still a long way off the targets stipulated in the AEC Blueprint. It will not be possible to achieve the milestones formulated in 2007 by the end of the year – either by the deadline or shortly after. Yet despite this, the mood remains optimistic. The ASEAN Business Outlook Survey 2015, a survey conducted by the US Chamber of Commerce, concluded that 66% of companies surveyed expect ASEAN to play an increasingly important part in their business. Some 89% even anticipate positive development by 2020 – even if they also expect it to take at least as long until the objectives of the AEC can be implemented.

The AEC is seen more as work in progress, in which the challenges cannot simply be played down. This also applies to everything that has been achieved in the last ten years. The progress recorded is difficult to present in figures, although this has not prevented the ASEAN Secretariat, the control centre for the community of states, from trying. To create transparency and provide an overview, it introduced the so-called AEC Scorecard in 2008. This was to be used to compile and measure successes and progress, as well as to make reference to outstanding implementations. However, the latest version of the AEC Scorecard is now already three years old. Back then, the member states had officially reached 67.5% of their objectives. Depending on which sources and estimates are to be believed, the current level of target achievement is somewhere between 80% and 85%. Indeed, an announcement was made at the 26th ASEAN Summit in April 2015 that some 91.5% of the "prioritised" objectives to be met by the end of 2015 have already been achieved. These, for example, include the sectors of air freight, healthcare, tourism, logistics and "e-ASEAN", a treaty that targets preparing the ASEAN states for the Internet age. As such, many people are keen to see whether the upcoming ASEAN Summit in November will unveil an updated version of the scorecard with an official estimate regarding the percentage implementation of the AEC Blueprint. The masterplan itself could then contain new information that stipulates the path to be taken up to 2025.

Based on official information, the degree of implementation differs in the various areas of the AEC, the "four pillars" mentioned at the start of the article. According to various reports, the states in the common market have currently met around 86% of the targets they set themselves. This revolves around freedom of movement in terms of goods, services, skilled labour, investment and capital. Introduction of the ASEAN Single Window, together with the accompanying National Single Windows for customs duties, is considered a milestone. These are platforms for uniform, faster and more transparent customs charge processing among the member states. In addition to this, they should provide increased security when exchanging data. After being registered once, goods imported from outside the ASEAN region can largely be moved freely among all member states already participating in the system via the ASEAN Single Window. To date, these are the six nations with the strongest economies. As the Asian Development Bank (ADB) writes in an analysis, the positive effects of measures such as these, which accelerate the movement of goods, should not be underestimated. Indeed, the private sector repeatedly complains about the high costs associated with lengthy, unfathomable, bureaucratic and redundant processes.

According to information provided by the ASEAN Secretariat, some 99% of all imports and exports (and thereby 70% of all intra-regional trade) are now duty-free within these "ASEAN-6". The remaining four countries recorded quotas of around two thirds to four fifths, as summarised by the German Trade and Investment Association (GTAI). Intra-regional trade increased by more than a third between 2008 and 2013 to USD 608.6 billion. According to the World Investment Report 2015, an increase in infrastructure can be observed among FDIs, particularly at the intra-regional level. The GTAI believes this signalises growing connectivity between the countries and economies, focussing on energy, telecommunications, transport and water management.

The fourth "pillar" of the AEC, integration into the global economy, is already thriving. In the last few years, several free trade agreements have been established between ASEAN and the following five countries: China, India, South Korea, Australia and New Zealand. The treaty between China and the ASEAN-6 was introduced back in 2010 and represents, at least on paper, the world's largest free trade area in terms of population. However, it is restricted only to exemption from customs duties on around 90% of imports into the ASEAN region.

Alongside this, the group engages in regular exchange with representatives from countries such as Japan, South Korea, China and Russia via various forums such as the East Asia Summit and the ASEAN Regional Forum. These events are complemented by a whole range of bilateral treaties between various member states. As such, ASEAN has long since been pursuing the objective of developing into a kind of hub in terms of free trade in the region. Indeed, a direct link was recently created to the Trans-Pacific Partnership (TPP) with Singapore, Vietnam and Malaysia. The negotiations for the planned trade agreement were successfully completed at the start of October and, following ratification, could create the world's largest free trade area in terms of its proportion of global economic output. With the Regional Comprehensive Economic Partnership (RCEP), the ASEAN nations are playing a key part in creating a potentially even more extensive economic zone that also includes China and India.

In the last few years, a whole host of institutions has been established to prepare the member states for the changes associated with the "third and fourth pillar" of the AEC. The ASEAN Qualification Reference Framework is a network that helps establish standards which allow skilled labour and training to be compared between the countries. For example, this should make it possible to determine whether a nurse training in Vietnam works to similar quality standards as a nurse training in Indonesia. In terms of using infrastructure to level the playing field with regard to the various development standards, in a paper published in 2014 the ASEAN Secretariat reported discernible progress, for example in the construction of an ASEAN Highway Network between the states or installation of power and gas lines that go beyond national borders. Among other things, 30 incubators and investment centres were established to provide support for small and medium-sized enterprises (SMEs) – a key duty on the road to greater equality, as reported by the ADB.

Based on estimates of the joint Secretariat of the ASEAN Intellectual Property Rights Action Plan 2011–2015, further accomplishments include the measures for protection of intellectual property rights, as well as the ASEAN Comprehensive Investment Agreement (ACIA). This should ensure fair and equal treatment of investments from outside the region. The ASEAN Open Skies Agreement is set to liberalise aviation and contribute to visa-free travel within the region for the citizens of all member states. In the future, anyone wishing to travel by land can do so with just a common driving license for the ASEAN region. Although an agreement for mutual recognition of driving licenses was previously in place, implementation was only half-hearted at best. However, the common ASEAN driving license also shines light on an important issue: It is questionable whether all involved institutions of the member states, such as traffic authorities and police, have the necessary means to implement the approach, let alone being capable of guaranteeing cross-border communication.

Almost 3,900 non-tariff barriers

Common driving licenses are just one of the lesser challenges that the AEC is facing. Even the almost 3,900 non-tariff trade barriers (NTTBs) that are still in place appear a Herculean task in comparison. As if this were not difficult enough, several more have also been added in the last few years: According to information provided by the Global Trade Alert Database, some 186 new NTTBs came about after the financial crisis between 2009 and 2013. The majority of trade barriers apply to foodstuffs and agricultural products. For example, the state-operated National Food Authority (NFA) governs rice imports in the Philippines and purchases domestic rice as a way of stabilising prices. This should help protect Filipino farmers against competition from countries such as Thailand and Vietnam. The Philippines are among the world's largest importers of rice. Similar systems are also used in other countries such as Indonesia and Malaysia and for other products, such as sugar.

Electronics, electrical engineering and machines are also heavily affected. NTTBs crop up in the most diverse of forms here, including: Customs fees, technical measures, requirements of certain product categories and monopolistic measures, such as state intervention in trade or the use of certain companies and groups for imports.
In various countries, products must still pass a whole range of tests, many of which are now redundant, in order to gain approval. In many cases, they need to have labels applied in the respective official language. Vietnam, for example, has highly restrictive rules in terms of franchising for foreign companies. In Indonesia, there is a negative list that defines the areas in which foreign investors may become active without a local joint venture partner. In Singapore, employers have been complaining

about stricter rules in the employment market since 2011.

It is important to follow protocol in removing hurdles of this kind: Following the verification of information via existing NTTBs, subsequent prioritisation of products and development of specific work programmes, the Economics Ministers of the ASEAN states are ultimately to receive the mandate to implement these programmes. The member states are currently in the process of verifying the list of NTTBs. Optimists stress that this represents a step which should not be underestimated. Yet despite this, the current state of affairs means it is still likely to take a long time before the number of non-tariff trade barriers has been reduced to an acceptable level.

Little progress in terms of services

Freedom of movement in terms of services is still considered particularly underdeveloped. In the future, services are likely to become an increasingly important economic factor – whether in the field of information and communication technology (ICT), education or healthcare. Around 40% of the ASEAN population already works in the service sector today. Modern and internationally deployable services are also being offered in the member states increasingly often, as reported by the ADB. According to a report by the World Bank, the sector primarily remains underdeveloped with little integration because it must comply with tight restrictions in all countries except Singapore. Protecting migrant workers, for example in countries such as Thailand, Indonesia and the Philippines, is a particular problem. Although a treaty that is supposed to clarify these questions has been in place since 2007 in the form of the Declaration on the Protection and Promotion of the Rights of Migrant Workers, the countries sending and receiving the workers are still arguing over the definitions and content.

A new approach is to relax the freedom of establishment legislation for careers from eight selected sectors, including architecture, dentistry, tourism, accounting and engineering. However, employees often need to pass examinations before being allowed to work in the country of their choice. For example, a doctor in Indonesia must pass a test in the official language of Bahasa. The Straits Times reports that there are currently around 50,000 licensed doctors in Thailand – although only 200 of these are foreign. The last foreign physician to qualify was Japanese and that was back in 2010. Certain services are also reserved exclusively for local citizens. In addition to this, the AEC only aims for free movement of skilled labour. However, the majority of labour migration takes place in the low to medium skilled area.

Poor protection for intellectual property

Protection of intellectual property is an important factor for economic integration and for investors deciding whether to establish new production sites for goods with high added value in a country. There is a great need for improvement in this field.

The International Intellectual Property Index 2015 (IIPI) of the US Chamber of Commerce's Global Intellectual Property Center assesses 31 countries based on their intellectual property protection effectiveness. Each country can achieve a maximum of 30 possible points in this rating. Indonesia, for example, currently scores just 8.6 points. Although the country was recently able to pass a new Copyright Act that, for example, allows the government to block websites with copyright infringement, there is still no other country among those analysed by the IIPI that displays a higher level of software piracy. There is a general lack of credible penalties for violating laws. Vietnam and Thailand fair even worse, with just 7.8 and 7.1 points respectively. In fact, Thailand can be found right at the bottom of the IIPI list. Although the government in Bangkok has made concerted efforts, for example by setting up additional checkpoints at its borders to improve controls, and is also seeking to counter Internet piracy, the latter remains a major issue in this country. No such systems are in place in Myanmar. However, things look better for Malaysia. With a score of 14.6 points, this country sits right in the middle of the pack. By way of comparison, Germany currently has a score of 27.3 points.

The problem, particularly for companies that come from outside the ASEAN region, could potentially be made even more acute by the ASEAN Single Window. The EU's South-East Asia IPR SME Helpdesk warns that once a product has passed the Single Window, it can then be moved freely through the other countries participating in the platform. As such, it advises foreign companies to themselves arrange the necessary IP protection in all potential destination countries in the ASEAN region – insofar as corresponding frameworks are present.

The ASEAN Intellectual Property Rights Action Plan 2011-2015 is set to improve this situation. It should provide the member states with a framework that will enable them to establish an effective policy. For example, it stipulates that companies can in the future submit a central application to have a trademark protected in all participating countries. The ASEAN Patent Examination Cooperation Programme (ASPEC) aims at promoting exchange among nine of the ten national patent offices in the ASEAN community.

Although there is still a lot of catching up to do here: If we compare the situation with China, the ASEAN region already enjoys a slight competitive advantage – at least if we believe the IIPI, which awarded China a score of 12.4 points.

Poor level of awareness and hesitant driving forces

The many tasks to be addressed on the road to the AEC do not end with non-tariff trade barriers or intellectual property.

The AEC often has to battle a low level of awareness and, just like the rest of the free trade world, also faces a certain degree of resentment. According to a survey undertaken by the Institute of South East Asian Studies last year, over half of SMEs in the region are not even aware of the planned free trade area. Even the most recent "Survey on the ASEAN Community Building Effort" undertaken by the community of states, although performed back in 2013, concedes that the "overall understanding among both the general public and companies is low", and describes the progress made in terms of preparations by the private sector as "minimal".

According to the CIMB ASEAN Research Institute, only around one in five domestic companies were already intensively addressing the AEC. However, this should not really come as a great surprise if we consider the large number of small and very small companies in these countries, whether restaurants, backyard workshops or tuk tuk operators. It is also important to note that the situation could well look markedly different among larger and especially foreign companies that are active in the ASEAN region. The ASEAN Business Outlook Survey 2015 states that in 2014 around 54% of CEOs at US companies were actively preparing themselves for the effects of the AEC.

In the largest ASEAN member state of Indonesia, concerns and a certain amount of resistance have become apparent over the last few months. Yet Indonesia, which is responsible for around 30% of economic output in the ASEAN region, should actually be a central driver of the AEC. As the GTAI reports, voters have developed "a propensity towards greater protectionism and nationalism in the last few years." Ex-pats have also repeatedly reported a "significantly more restrictive visa policy."

The government is, for example, battling with the rather unsuccessful Batam Free Trade Zone, which was established in 2007 based on the model of Chinese free-trade areas such as Shenzen. As a result of slow developments, as well as some protests and even riots among the workers, several large international companies such as Volkswagen have already chosen to leave the zone. According to reports published in the Jakarta Post, Indonesia decided to reconsider the project and examine whether to return control of the autonomous zone back to the country's capital. The Batam Free Trade Zone is a joint project with Singapore. According to media reports, the city state welcomed this decision. However, the signals this sends out for Indonesia's handling of free trade are ambivalent.

A question of capacities

Corruption remains a widespread problem in many member states. Whether Cambodia, the Philippines or Indonesia, almost all of these countries suffer just as much from this corruption as from their escalating bureaucracy. The rule of thumb here is: The less developed, the more susceptible to corruption. According to the Corruption Perception Index 2014, published by Transparency International, the CMLV states perform particularly poorly in this regard: Cambodia is in 156th place out of 175, while Vietnam is 118th. Indonesia fairs slightly better in 107th place. Thailand and the Philippines share 85th place – and are thereby still 15 spots ahead of China.

In many cases there is simply a lack of capacities, which are for example required for the complex networking of various border posts, ports, authorities and customs facilities, including setting up new IT infrastructures and training staff in the sense of the National Single Window. Governments need to make additional resources available to implement measures of this kind. Institutional interests must be overcome if, for example, authorities are to hand over expertise and responsibility to a central coordination point.

According to Thailand's Department of Trade and Industry, the country has already implemented eight of ten packages of measures in the lead up to the AEC, including opening up the service sector to foreign investments in at least 83 categories. However, little has now happened here since 2013. The implementation of complex liberalisation processes requires the approval of a whole host of authorities and political bodies. With the unrest and coup last year, the country fell behind schedule.

As the example of intellectual property shows, there is also a lack of sanction mechanisms. Set against the background of the self image associated with the "ASEAN way", this is a particular challenge. The AEC Scorecard, for example, is also a kind of compliance tool in the sense that it should allow grievances to be publicly aired and the pressure to act to be increased for the participating states. Yet the extent to which it is actually suitable for this purpose is questionable. The picture it paints is too cloudy, fuzzy and fragmented. Its data is based on voluntary self-assessment. It does not deliver any analyses or explanations for delays or failures. Individual country scorecards are not published. Lists of prioritised NTTBs remain non-transparent. The actual implementation of the measures in practice is not presented at all. Instead, only the assumption of the identified "to dos" and corresponding measures are shown. An ASEAN member may well have officially implemented liberalisation – but to what extent such liberalisation is genuinely implemented on a day-to-day basis is an entirely different matter.

The ASEAN Secretariat also has a capacity issue. It has always been considered understaffed and lacking in assertiveness, and this has not changed in the last few years. It comprises around 300 employees, which is an almost alarmingly low number given the total population in the region. The low wages that the Secretariat can pay represent another issue. For 2015, the organisation had a budget of around USD 19 million. All member states pay the same contributions, regardless of their size or economic output. However, to ensure that the poorest member is also able to make its payments and enjoy full membership, these contributions are kept relatively low for everyone. Although comprehensive third-party funds are made available, these offer little in the way of planning security. The organisation's central institution has achieved great success by promoting dialogue and cooperation among the member states. Yet in light of these framework conditions, even their capacities are limited.

Summary

The situation is also compounded by the fact that the ASEAN Secretariat also has only limited expertise. We must therefore assume that the increasingly complex and sensitive stipulations of the AEC will sooner or later require credible monitoring and sanction mechanisms. A cautious comparison with historical events in terms of economic integration in Europe underlines this. The Secretariat can neither offer mechanisms of this kind, nor are they desired. Any notion of interference by a supranational institution in national issues goes against the whole concept of the "ASEAN way". According to Jayant Menon, Chief Economist at the Asian Development Bank's Office of Regional Economic Integration, this may potentially provide a "comfortable pretext for non-compliance" with the agreed provisions.

It is clear that not all objectives of the AEC are met by the end of 2015 as per the ASEAN Blueprint. Implementation of the measures in the AEC catalogue will not lead to a "common market" from January 2016 anyway. This was something already stressed by ASEAN representatives at the start of the year at a summit in the Malaysian city of Kota Bharu. Instead, the date is being seen as a "strong signal that positive measures are being established for a more heavily liberalised and integrated economic region."

There is no question that a great deal has been achieved in the last few years. The markets have enjoyed rapid development in the ASEAN countries. Indicators such as foreign direct investment and increasing intra-regional trade serve to underline this. Japanese companies in particular, as well as an increasing number of Chinese enterprises, are now investing here, not least in major infrastructure projects such as ports, railway links and industrial estates. This shows that they have come to stay. Just like other foreign companies, investors from China and Japan are optimistic about development of the ASEAN region. This also applies to German companies, as became clear during the regional meeting of the German economy, the Asia-Pacific Conference held in Ho Chi Minh City at the end of 2014. Here, emphasis was placed on the role of the market and of companies in securing further economic integration.

About the author: Patrick Bessler is a freelance journalist and communication consultant. Prior to this, the Japanologist and political scientist managed the PR Department at the Japanese Chamber of Commerce and was editor-in-chief at "Japanmarkt".
E-mail: patrick.bessler@gmail.com

Konrad Adenauer Stiftung
Social and Economic Governance Programme Asia / Japan Office

OAG-Haus 4F
7-5-56 Akasaka, Minato-ku
Tokyo, 107 0052 Japan
Tel. +81 3 6426 5041
Fax. +81 3 6426 5047
KAS-Tokyo@kas.de
www.kas.de/japan/en
www.facebook.com/KAS.Japan