

The ASEAN Economic Community and the European Experience



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Goals of the Paper

- *Delineate Relevant European Lessons for the ASEAN Economic Community (AEC)
- *In Light of This Analysis, Explore Optimal Characteristics of the AEC



Summary of Presentation

1. Statistical Overview of the Determinants of trade flows in the EU-ASEAN Context
2. Overview of Evolution of ASEAN Institutional Integration up to AEC
3. Analysis of European Lessons for AEC
4. Recommended Approaches for AEC



I. Trade Links and EU-ASEAN

1. Of Triad, EU is number 2 market for ASEAN exports; number 1 for Vietnam, Laos.
2. However, most of ASEAN at bottom of EU Pyramid of Preferences
3. Has ASEAN suffered from trade diversion and inward-looking EU policies?



Trade Links and EU-ASEAN, continued

- We consider two major empirical questions in this regard:
 - a. To what degree do ASEAN Countries compete with each other and key competitors like China in the EU?
 - b. To what degree is ASEAN a significant trading partner of EU?
 - c. Has ASEAN economic integration succeeded in influencing international and regional trade flows?



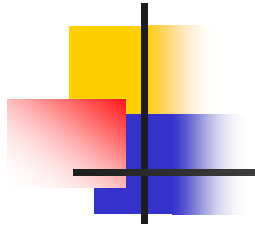
Trade Links and EU-ASEAN, continued

- In order to answer these questions, we use:
 - A. Spearman Rank Correlation Coefficients to capture competitiveness effect
 - B. Gravity model, based on Rose (2003) to capture ASEAN trade effects



Trade Links and EU-ASEAN, continued

- SRCC:
 - A. Non-parametric estimate of correlation of two series, in our case exports to EU
 - B. Range: -1 to +1; 0=no correlation
 - C. Sample: 5-digit SITC (2881 possible commodities) to avoid aggregation bias.
 - D. All estimates statistically significant



	China	China	Indonesia	Malaysia	Philippines	Thailand
China						
1999	-	0.24	0.21	0.35	0.31	
1995	-	0.22	0.20	0.33	0.29	
Indonesia						
1999	0.24	-	0.11	0.13	0.21	
1995	0.22	-	0.08	0.08	0.20	
Malaysia						
1999	0.21	0.11	-	0.11	0.19	
1995	0.20	0.08	-	0.12	0.21	
Philippines						
1999	0.35	0.13	0.11	-	0.21	
1995	0.33	0.08	0.12	-	0.19	
Thailand						
1999	0.31	0.21	0.19	0.21	-	
1995	0.29	0.20	0.21	0.19	-	



Trade Links and EU-ASEAN, continued

- Gravity Model:
 - A. Standard augmented gravity model
 - B. Benchmark: 1948-1999 for 178 countries, quarter million observations
 - C. Key conclusions from standard runs:
 - 1. ASEAN always statistically significant in determining trade flows.
 - 2. Currency Union has important effect on trade
 - 3. GSP also important in post-1970 regressions

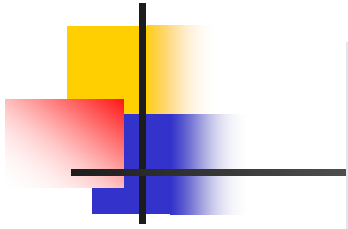


Trade Links and EU-ASEAN, continued

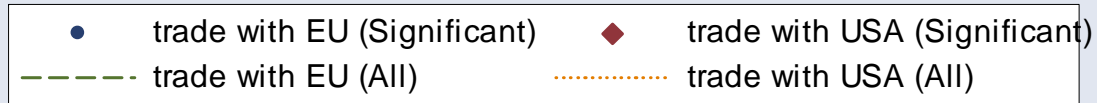
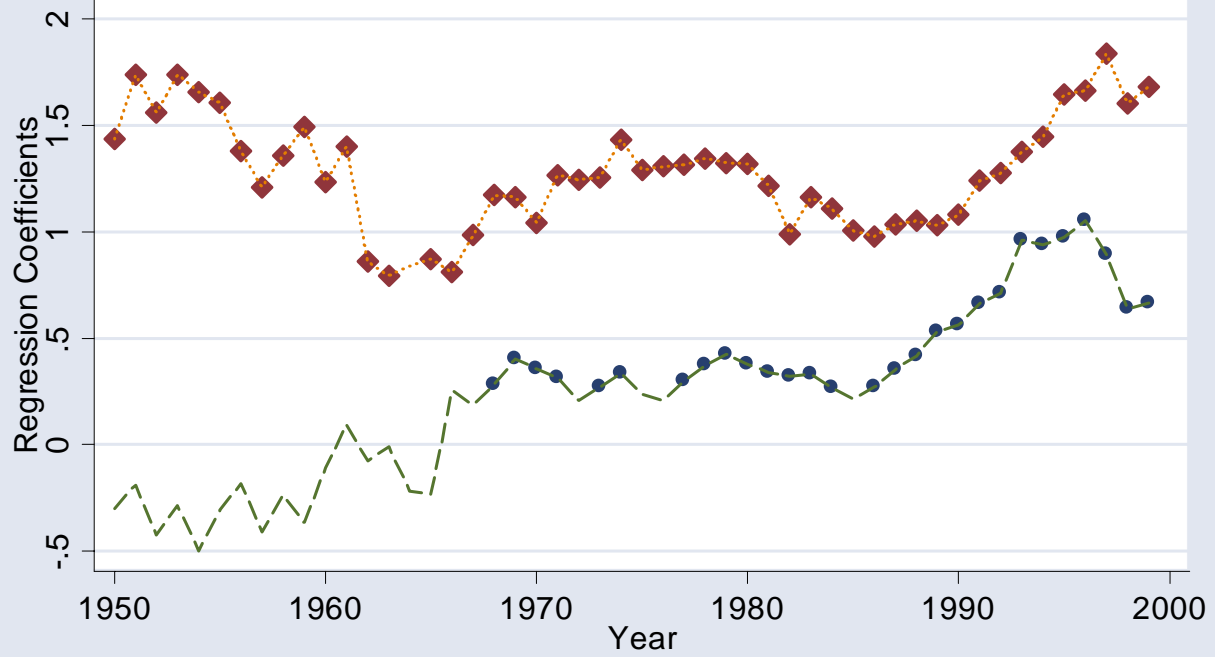
E. For Individual Country/Group, panel data based regressions, ASEAN binary statistically significant for US, NAFTA, EU and ASEAN regressions, but especially US.

F. For Individual Years, US and EU Trade:

- 1. Strictly increasing ASEAN effect after liberalization process in 1980s until Crisis**
- 2. Same for EU, until Single European Act (SEA) came into effect (early 1990s). Trade Diversion?**



ASEAN Gravity Regression, Original Asean Countries





Trade Links and EU-ASEAN, continued

In sum:

- 1. ASEAN is an important determinant in global, EU, and ASEAN trade flows.**
- 2. Monetary integration is especially important; trade-finance link of the essence**
- 3. ASEAN has likely suffered from Trade Diversion: case for cooperation due to regain MFN and gain edge over China in EU**



II. Evolution of ASEAN Integration

We have little time and this group is expert, so I'll be brief!

1. ASEAN Integration at first was superficial, and this was fortunate: direction was wrong (and this is true for certain existing developing country groups today)
2. "Serious" approaches to integration began late 1980s, when political exigencies receded
3. AFTA was milestone in regional integration, both due to its being first FTA in Asia and its "policy signal"
4. AFTA as much of a investment accord as a trade accord; followed by AIA and AFAS, which has a long way to go



Evolution of ASEAN Integration, continued

- ASEAN Economic Community (AEC):
 - 1. Proposed in Nov 2002; endorsed at Bali Summit in Oct 2003
 - 2. Reasons:
 - A. New, comprehensive post-AFTA agenda
 - B. Perceived need to deepen integration, given new regional zeitgeist and potential trade/investment diversion
 - C. Fear of diluting ASEAN cooperation due to bilateral FTAs of ASEAN partners



Evolution of ASEAN Integration, continued

- *AEC Reasons, Continued*
- D. Lessons from Asian Crisis regarding need to link financial/monetary and trade integration
- E. Perceived success in EU, both in terms of SEA and implementation of euro



III. Lessons from the EU

I. Caveats in Making Comparisons:

- 1. Institutional Environment facing ASEAN in 2000s different than EEC in 1950s:
 - a. “European Good” after war, forcing cooperation beyond economic institutions
 - b. Security considerations
 - c. Easier to create supranational institutions in that environment, relative to ASEAN
 - d. Moreover, European supranational institution building has mixed record and is EXPENSIVE



Lessons from the EU, continued

- 2. *International* environment is very different today
 - A. International marketplace is far more open; cost of inward-looking policies, like those of early EEC, higher.
 - I. Puts constraints (luckily!) on compromises like CAP.
 - II. “Tariff Hoping” FDI gives way to “Competitive FDI”
 - B. New Regionalism poses new challenges to ASEAN that the EEC never had to face; ASEAN cannot look inward as it relies far more on non-ASEAN markets. Must be far more concerned about trade/investment diversion due to regionalism elsewhere



Lessons from the EU, continued

- 3. ASEAN faces far greater diversity
- A. ADB (2002): coefficient of variation on ASEAN per capita GDP: 1.6, among highest in world. EU=0.6 (before 2004 expansion)
- B. Greater diversity in terms of economic policy (as well as other social aspects of cooperation)
- C. Makes deeper integration more difficult
- D. Complicates speed of implementation of integration
- E. 10-X?



Lessons from the EU, continued

- 4. ASEAN countries are far more open than was the case for EEC. As such, the costs of inward-looking policies are far higher; AEC has no choice but to be open, unlike the EEC.



Lessons from the EU, continued

- II. Specific Lessons:
- 1. AEC needs to embrace an outward-oriented approach to integration
 - A. Inward policies didn't work even in EEC context, though this could be debated
 - B. They would be disastrous for ASEAN, which is more open and trades more with non-partners
 - C. ASEAN is relatively poor and cannot afford it anyway



Lessons from the EU, continued

- 2. The EU experience testifies to importance of trade and investment links
 - A. Integration didn't really take off until SEA, with FDI/capital-flow integration aspects
 - B. Structural transformation in ASEAN is being driven in large part by FDI (especially in its more important sector, electronics) and this puts a higher premium on need for recognition of such links
 - C. Empirical studies underscore importance of link



Lessons from the EU, continued

- 3. SEA was necessary to create a truly integrated market.
 - A. Customs union: necessary but not sufficient condition for market integration
 - B. Prior to SEA, EC market was segmenting even further
 - C. Non-border, facilitation, and “best-practices” aspects of SEA yielded greater gains (Cecchini Report 1986)
 - D. SEA affects trade, FDI and finance



Lessons from the EU, continued

- 4. Financial and monetary cooperation and integration need to be undertaken *in tandem* with real integration
 - A. Financial integration separate prior to SEA; very little progress in terms of integrating markets
 - B. Monetary cooperation (besides EPU) not so important in 1950s-1973, due to Bretton Woods. Still:
 - I. Werner Report (1968) due to internal problems in BW
 - II. Post BW cooperation not successful in 1970s, before EMS (1979). ECU was key to market integration
 - III. Single banking market only with SEA



Lessons from the EU, continued

Financial and monetary cooperation, continued

IV. ECU bond market took off spontaneously after 1981

V. Monetary union was really a long process; one has to start off slowly.

VI. AEC does not have at present the same motivations for monetary union as the EU: While the economics are just as good, the politics are not there, though they are getting better in wake of Crisis

VII. However, ASEAN has perhaps even a greater incentive to integrate capital markets, due to liquidity problems at national level and problems associated with one-pillar finance system (banking).



Lessons from the EU, continued

- *Financial and monetary cooperation, continued*
- VIII. After Hanoi action plan and AEC, ASEAN has placed a priority on capital market integration
- IX. ASEAN Bond Market idea is being replaced by Asian Bond Market idea. First step: Asian bond pool
- X. Many institutional problems to overcome in order to achieve this. In some ways, EU not there yet.
- XI. European experience underscores importance of Common Currency Basket



Lessons from the EU, continued

- 5. Developing institutions are important:
 - A. But EU has arguably gone “overboard”; much critique of EU institutions; popular protest against them (e.g., referendum on EU Constitution).
 - B. Economic institutions were most important in EU; commercial policy was only integrated policy.
 - C. Even if it takes an *de minimus* approach, ASEAN has a long way to go in creating institutions to support the AEC.



IV. On Building the AEC

- 1. Great complications, given diversity of region and especially CLMV. NOT faced by EEC.
- 2. Diversity in tariff structure makes customs union tough; Singapore can't raise tariffs from zero; tough politically for others to embrace zero tariff CET
- 3. 10-X is always possible but suboptimal, given need to integrate markets



On Building the AEC, continued

- 4. CET:
 - A. Need it; 10-X only if X is transitioned in. EU experience show that gains limited otherwise
 - B. Set at: 0-5%. This would:
 - I. Reduce transactions costs substantially
 - II. Mitigate any TD; true “open regionalism”; not new (Philippine proposal to mulilateralize AFTA cuts)
 - III. Facilitate ability to negotiate regional accords, as well as integrate existing accords of Member Countries (“spaghetti bowl” effects would also be mitigated)
 - IV. Increase clout in international negotiations (EEC experience clearly bears this out)



On Building the AEC, continued

- V. Certainly, this will prevent ASEAN Members from using industrial policy through trade. However:
 - I. Not particularly effective anyway (arguably)
 - II. Transition period (through 2020; perhaps longer for CLMV) long...15 year transition for infant industries?!
 - III. As EU shows clearly, Members can still use other means of industrial policy



On Building the AEC, continued

- 4. Labor market integration also difficult; unskilled labor flows left out but skilled to be included. Makes sense; most important for FDI. Many challenges (e.g., mutual recognition of professional qualifications).
- 5. Free flow of capital: FDI, easy. Rest will take considerable effort, but there is political will (with safeguards?).
- 6. AEC must go much further in terms of services; difficult but could lead to significant gains. AFAS has not gone far.



On Building the AEC, continued

- 7. To complete AEC, ASEAN will ultimately also need other aspects of SEA, e.g.:
 - A. mutual recognition of product testing;
 - B. technical standards;
 - C. food/health related standards; and
 - D. other forms of harmonization.
 - E. Long process, but could be based on “best practices”.
 - F. Likely worth it: said to be key among greatest SEA gains.



On Building the AEC, continued

- 8. Institutional development, never an ASEAN strongpoint, will have to receive a high priority.
 - A. ASEAN Secretariat: beefed up drastically: “to the minimum possible but no less than that” (particularly due to cost, brain drain, waste in EU).
 - B. But no need for focus on social institutions to the degree EU did.
 - C. Keep supranational institutions to a minimum; take “subsidiarity” to the greatest extent possible.
 - D. Some sort of ASEAN judiciary for economic-related issues.
 - E. Needs to be an evolutionary process (like EU).



V. Concluding Remarks

- **1. ASEAN is an important determinant in global, EU, and ASEAN trade flows. Intra-regional cooperation, as well as integration with key non-partners like the EU, is arguably of critical importance today.**
- **2. The AEC has developed organically, in response to national, regional, and global influences. It is an ambitious project given the current state of integration.**
- **3. The EU experience holds myriad lessons for the AEC, both positive and negative.**



Concluding Remarks, continued

- 4. Depending on how it develops, the AEC could go a long way in creating a single market within ASEAN.
- 5. If outward-oriented (and we argue there could be no other option for ASEAN), the AEC could generate significant benefits to the region.
- 6. But the process will be complicated and it will take significant political will.

THANK YOU!

I LOOK FORWARD TO
DISCUSSION



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