TOWARD AN ASEAN ECONOMIC COMMUNITY—AND BEYOND[25]

Introduction

The Association of Southeast Asian Nations (ASEAN) is arguably the most durable and successful regional association in the developing world.

The push toward regional economic integration was not a major part of the ASEAN agenda during its first decade. Between its establishment in 1967 up until the mid-1970s, ASEAN's primary focus was on creating harmony and cohesion within the region. Tentative steps toward economic cooperation only began in earnest in 1976, with the launch of the ASEAN Preferential Trading Agreement (APTA)—the first major attempt to promote intra-ASEAN trade through institutional integration and regional trade preferences. Over the succeeding decades, pursuing regional economic integration has gained prominence in ASEAN affairs. From the initial focus on trade liberalization—through APTA and eventually the ASEAN Free Trade Agreement (AFTA)—ASEAN's regional economic integration agenda has broadened to include services trade, investment, labor migration, and even macroeconomic policy, although progress in these new areas has been mixed (Hill and Menon 2012).

ASEAN's regional economic integration will reach an important milestone by end-2015 with the creation of an ASEAN Economic Community.

As part of ASEAN's Vision 2020, one of the three pillars of the ASEAN Community is the establishment of an ASEAN Economic Community (AEC)—the other two are a Security Community and Socio-Cultural Community. ASEAN leaders had originally intended to create the AEC by 2020, but in early 2007 they advanced the deadline to 2015. Three factors prompted the shift to an earlier date. First was the need to maintain the centrality of ASEAN's role in the face of proliferation of free trade agreements (FTAs) between ASEAN and its dialogue partner countries. Many of ASEAN's FTAs aim to be completed by 2015 or earlier—if the ASEAN market is not fully integrated before its FTAs are in place, its role as an integration hub in Asia could erode. Second was the desire of ASEAN leaders to expedite ASEAN economic integration and take it to the next level. And third was the growing concern over the erosion of ASEAN competitiveness vis-à-vis key competitors—such as the People's Republic of China (PRC) and India.

At the 13th ASEAN Summit held in Singapore on 20 November 2007, the ASEAN leaders adopted the ASEAN Economic Blueprint for an AEC. It defines four pillars of the AEC, contains 17 'core elements', and 176 priority actions to serve as a guide. It also contains agreed goals and specific commitments to be carried out within definite timelines, with a "Strategic Schedule" in the form of a matrix specifying "Priority Actions" to be undertaken over four 2-year periods from 2008 to 2015.

Progress is measured through an AEC Scorecard mechanism, established in 2008. The AEC Scorecard is a self-assessment tool that monitors the achievement of milestones indicated in the Economic Blueprint's Strategic Schedule. It also tracks specific actions that must be undertaken by ASEAN member states, both individually and collectively, to establish the AEC (Das 2012).

Fulfilling these commitments would promote predictability in ASEAN, as well as strengthen its credibility. But with only 2 years remaining before the 31 December 2015 deadline, many are still wondering—will the AEC become a reality in 2015, or will it remain essentially a vision statement? Or will former ASEAN secretary general Rodolfo Severino's warning apply to the AEC, that "regional economic integration … [becomes] stuck in framework agreements, work programs and master plans", with little real movement on the ground? (Severino 2006).

[25]Parts of this chapter draw upon material from *The ASEAN Economic Community: A Work in Progress,* particularly the Overview Chapter prepared by Rodolfo Severino and Jayant Menon. The study is a joint publication of ADB and the Institute of Southeast Asian Studies (ISEAS).

Measuring Progress: The AEC Scorecard

ASEAN's biggest strides in achieving an AEC have been in Pillar 4—integrating into the global economy.

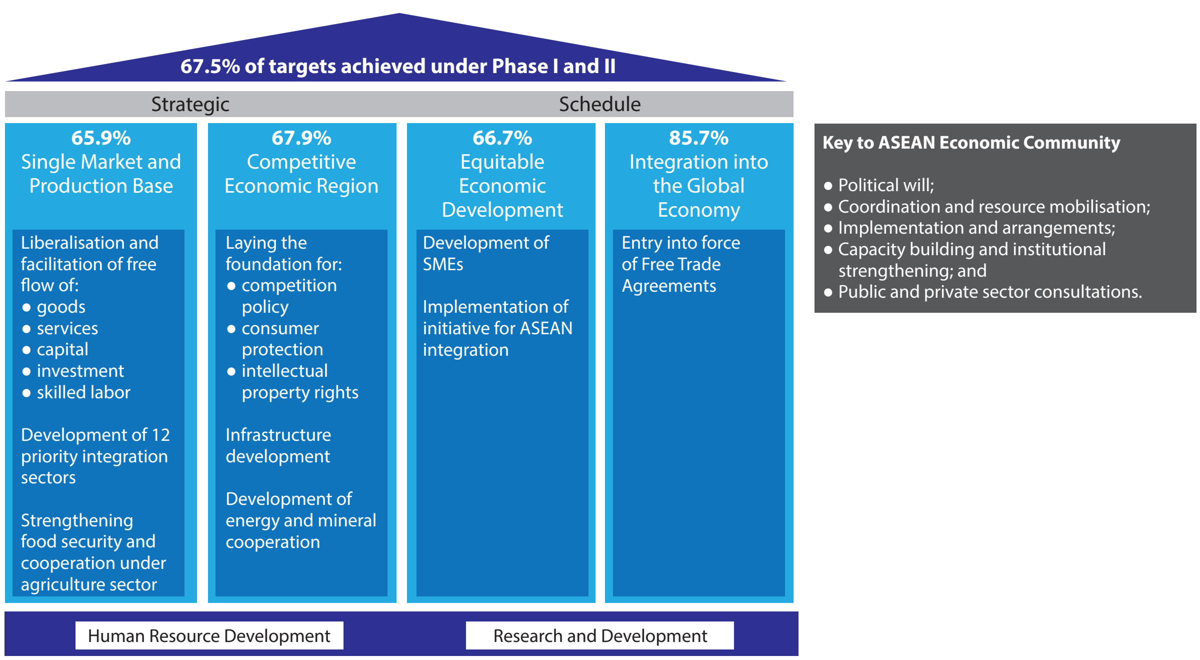
The ASEAN Secretariat has published two AEC Scorecards to date. The latest AEC Scorecard released in March 2012 shows progress toward the AEC reached about 68% of the targets between 2008 and 2011 (**Figure 35**). The biggest strides have been made in integrating into the world economy (Pillar 4, 86%). This is hardly surprising, given that ASEAN economies trade mostly with the rest of the world. Since 1970, intraregional trade has generally been between 15% and 30% of total ASEAN trade, and although this share has been trending upward, it remains low relative to the shares of ASEAN's external trading partners, particularly the European Union (EU) (Hill and Menon 2013).

In contrast to Pillar 4, progress in other areas of the AEC has been less stellar, with ASEAN as a whole achieving just a little over two-thirds of its targets in the other three pillars.

In particular, the score for Pillar 1 (creating a single market and production base) hints at the various obstacles to deepening economic integration within the region. Many of the achievements reported in Pillar 1 relate to tariff liberalization and other "low hanging fruit" reforms. ASEAN has removed customs duties on most intra-ASEAN trade, but this was mainly through AFTA.

There are positive developments worth highlighting. ASEAN members have formally adopted a Customs Code of Contact, national and regional "Single Window" systems, the ASEAN Harmonized Tariff Nomenclatures, and the World Trade Organization's (WTO) mode of customs valuation. They have concluded "framework" agreements on liberalizing trade in services, investment, goods in transit, multi-modal and inter-state transport, and information and communications technology. They have also agreed on mutual recognition agreements (MRAs) or their equivalent for three types of goods and seven professions, as well as concluding a "framework agreement" on MRAs (Severino and Menon 2013).

Figure 35: Implementation of AEC Scorecard under Phase I and II



Note: As of December 2011, the implementation rates under Phase I and Phase II are 86.7% and 55.8%, respectively.
Source: ASEAN. 2012. *ASEAN Economic Community Scorecard 2012*. Jakarta.

Overall, the AEC Scorecard shows that, since 2008, ASEAN has made slow but steady progress in reaching AEC goals.

Scorecard results, however, need to be taken with a grain of salt for several reasons. First, one must bear in mind that the AEC Scorecard is a compliance tool that relies on self-assessment. While ASEAN member states may be willing to give a fair and balanced view of their progress, the need to meet the 2015 deadline could understandably lead countries to overestimate compliance and achievement.

Second, the AEC Scorecard measures aggregate progress, thereby glossing over significant challenges to implementation within individual countries. Given the ASEAN's diversity—and sensitivities on different issues and sectors—members agreed that liberalization of goods, capital, and (skilled) labor flows would proceed at different speeds, according to each country's readiness. Thus, the "Strategic Schedule" remains saddled with loopholes and "flexibility" hedges, full of words and phrases like "minimal", "where appropriate and possible", "establish good practices", and "possibly" (Severino and Menon 2013). The Scorecard, however, fails to fully capture these differences. Although Annex 2 of the 2012 AEC Scorecard differentiates implementation of AEC targets by country, the information provided is still too general to give a country-specific picture of where the true bottlenecks lie (**Table 6**).

The third and perhaps biggest shortcoming of the AEC Scorecard is that it does not try to analyze or explain the results. In the case of achievements, progress toward realizing the AEC involve significant amounts of double counting, whereby reforms undertaken under different initiatives and before the AEC proposal was launched are still being added to the tally. In the case of shortfalls or delays in implementation, the Scorecard falls short of examining the reasons for these delays and suggesting ways to improve implementation (Das 2012).

Realizing the AEC: Obstacles, Challenges, and Possible Solutions

Given Scorecard limitations and doubts surrounding its ability to provide an objective assessment of implementation, the question remains—how far has ASEAN gone in carrying out the more significant commitments under the AEC Economic Blueprint? And why has ASEAN or its members succeeded or failed in achieving them? A joint Asian Development Bank (ADB) and Institute of Southeast Asian Studies (ISEAS) study (Das et al. 2013) examines this and offers recommendations on what needs to be done to realize the AEC. More specifically, the study examines a number of core elements under the AEC's four

Table 6: Implementation of AEC Scorecard by ASEAN Member States

	Free Flow of Goods	Free Flow of Services	Free Flow of Investment	Free Flow of Capital	Free Flow of Skilled Labor	Priority Integration Sectors	Food, Agriculture and Forestry	Competition Policy	Consumer Protection	Intellectual Property Rights	Transport	Energy	Mineral
Brunei Darussalam	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟠	🟠	🟠	🟢
Cambodia	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟠	🟠	🟠	🟢
Indonesia	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟢	🟠	🟠	🟢
Lao PDR	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟠	🟠	🟠	🟢
Malaysia	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟢	🟠	🟠	🟢
Myanmar	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟠	🟠	🟠	🟢
Philippines	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟢	🟠	🟠	🟢
Singapore	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟢	🟠	🟠	🟢
Thailand	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟢	🟠	🟠	🟢
Viet Nam	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟢	🟠	🟠	🟢
ASEAN	🟠	🟠	🟠	🟢	🟢	🟢	🟠	🟢	🟠	🟠	🟠	🟠	🟢

🟢 All measures targeted in this area were implemented
🟠 More than half of measures targeted in this area are implemented
🔴 Less than half of measures targeted in this area were implemented.

Lao PDR = Lao People's Democratic Republic.
Source: ASEAN. 2012. *ASEAN Economic Community Scorecard 2012*. Jakarta.

pillars that should be prioritized. These cover a host of policy issues (non-tariff barriers, competition policy and intellectual property rights, FTAs), sectoral issues (services, investment), and institutional and governance aspects (dispute settlement mechanism, strengthening monitoring of implementation), among others.

Pillar 1: Single market and production base

Perhaps not surprisingly, the biggest challenges facing the AEC relate to Pillar 1—creating a single market and production base. Even the AEC Scorecard cites Pillar 1 as the laggard among the four pillars.

The adoption of the ASEAN Trade in Goods Agreement and the ASEAN Comprehensive Investment Agreement are two significant achievements.

Without a doubt, ASEAN has made some major strides in reaching its goals for Pillar 1. The adoption of the ASEAN Trade in Goods Agreement (ATIGA) and the ASEAN Comprehensive Investment Agreement (ACIA)—which provide specific targets for ASEAN market integration and investment liberalization and facilitation—are two of the most significant achievements in this regard. To some extent, the two agreements were already on the table through initiatives prior to the announcement of the planned AEC, and were grandfathered in. Furthermore, ASEAN has now largely completed the relatively easy phase of promoting integration through intraregional trade liberalization. What remains are the economically sensitive sectors, such as agriculture, steel, and motor vehicles, and the more politically sensitive areas of reform, such as reducing non-tariff measures, pursuing faster liberalization in services and investments, and establishing an effective dispute settlement mechanism.

Table 6 continued

Information and Communication Technology	Taxation	E-commerce	SME Development	Initiative for ASEAN Integration (IAI)	External Economic Relations
🟢	🟢	🟢	🟠	🟠	🟠
🟢	🔴	🟢	🟠	🟠	🟠
🟢	🟢	🟢	🟢	🟠	🟠
🟢	🟢	🟢	🟠	🟠	🟠
🟢	🟢	🟢	🟢	🟠	🟠
🟢	🟢	🟢	🟠	🟠	🟠
🟢	🟢	🟢	🟠	🟠	🟠
🟢	🟢	🟢	🟢	🟠	🟠
🟢	🟢	🟢	🟢	🟠	🟠
🟢	🟢	🟢	🟠	🟠	🟠
🟢	🔴	🟢	🟠	🟠	🟠

Non-tariff barriers are increasingly replacing tariffs as protective measures and, unless addressed, can stand in the way of realizing the AEC.

According to the ATIGA Tariff Schedule of 2013, ASEAN members have 87.81% of their tariff lines at zero percent. ASEAN-6 countries have 99.20% of tariff lines on the inclusion List at zero percent, compared with 68.88% for the Cambodia–Lao People's Democratic Republic (Lao PDR)–Myanmar–Viet Nam (CLMV) subgrouping (MITI 2013).[26] And yet, while most ASEAN countries have complied with tariff reductions under AFTA/ATIGA, utilization of the common effective preferential tariffs (CEPT) has been relatively low. The WTO (2011), for instance, estimates that preferential trade only accounts for 20% of intra-ASEAN trade, with the majority of trade taking place under most favored nation (MFN) tariffs.

There are several reasons for this. The first are difficulties complying with rules of origin. Although the 40% value-added rule may seem straightforward on paper, in reality many members are unable to comply due to the high level of product fragmentation in the region, the high import content of major export products, and the administrative costs of proving origin. Furthermore, the margin of preference on most of these tariff lines are either zero or very low, taking away much of the incentive to use them (Menon 2013a; CARI 2013).

Another possible reason is the lack of progress in reducing non-tariff barriers (NTBs) to intra-ASEAN trade. These NTBs are increasingly replacing tariffs as protective measures and can stand in the way of realizing the AEC. Foremost among the factors contributing to the slow progress in tackling NTBs is the difficulty in identifying which non-tariff measures are barriers to trade.

[26] ASEAN-6 includes Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Effectively reducing NTBs will require several measures, such as giving NTBs a common definition; involving the private sector in identifying NTBs; subjecting all non-tariff measures to a compliance review to ensure that they are transparent and nondiscriminatory; and maximizing use of information and communications technology (ICT) for reporting, monitoring, and eliminating NTBs (Austria 2013). NTBs are not only wide-ranging, they can evolve over time, often in response to efforts to curtail them, and therefore present a formidable challenge to countries pursuing reform.

With more than 70% of intra-ASEAN trade tariff-free, and less than 5% subject to tariffs above 10%, the role of trade facilitation in reducing trade costs further is critical.

As a result of unilateral and multilateral efforts, as well as AFTA, tariffs in ASEAN are already very low. These achievements highlight the importance of trade facilitation in bringing down trade costs further. The Economic Blueprint covers several aspects of trade facilitation, including the harmonization and standardization of trade and customs procedures; customs modernization; integration of national single windows (NSWs) into an ASEAN single window (ASW); and harmonization of standards, technical regulations, and conformity assessment procedures. ATIGA also addresses trade facilitation challenges by including the ASEAN Framework on Trade Facilitation. This subsequently led to the adoption of the Trade Facilitation Work Program for 2009–2015. A number of agreements on transport facilitation and connectivity complement these initiatives, such as the ASEAN Framework Agreement on the Facilitation of Inter-State Transport, the ASEAN Framework Agreement on Multimodal Transport, and the Master Plan on ASEAN Connectivity.

While these recent initiatives have helped trade facilitation reforms move forward, data on trade costs and logistics continue to show considerable variation in trade facilitation and logistical performance across ASEAN members (Menon 2012). Private sector feedback from several members continue to cite excessive and time-consuming documentation requirements, as well as irregular and arbitrary payments for expediting customs procedures. There have also been delays and unevenness in implementing key reforms such as integrating NSWs into the ASW—with Cambodia, the Lao PDR, and Myanmar (CLM) lagging behind, and the rest in various stages of implementation (ERIA 2012). These challenges, coupled with the nonbinding nature of certain commitments—such as those under the 2005 Agreement and 2006 Protocol on the ASW (Dosch 2013)—make it unlikely the deadlines under the AEC will be met. For ASEAN to meet its AEC trade facilitation objectives, members will have to expedite the harmonization of business processes and data elements as well as address legal issues. Adopting clear timelines and trade facilitation performance targets to measure progress will also be helpful (Pellan and Wong 2012).

With services growing in significance as a share of GDP and employment, liberalization of this difficult sector is gaining importance.

The services sector is becoming increasingly important as a driver of growth in the region, both as a share of GDP, and of employment. Given difficulties with measurement, there is increasing recognition that its share in GDP and trade is probably much higher than reported. In principle, the liberalization of services under the ASEAN Framework Agreement on Services (AFAS) and the Economic Blueprint should have been significantly bolder than under the WTO's General Agreement on Trade in Services (GATS). In reality, however, ASEAN service liberalization has been slow. Existing commitments are insufficient. Nevertheless, AFAS commitments have improved over time, and now there are significant GATS-plus elements that have been adopted (Hamanaka 2013).

Liberalization—particularly in banking and financial services—has been hampered by built-in flexibilities introduced under the "ASEAN-X" formula, which allows member states to liberalize according to each country's readiness. In financial services, therefore, the scope of liberalization is not specified, and member countries are allowed to carve out subsectors that they are not ready to liberalize (Nikomborirak and Jitdumrong 2013).

In addition to these flexibilities, statutory or constitutional limitations on foreign equity, restrictions on land ownership, and impediments to professional or labor mobility across national boundaries also continue to work against fulfilling services liberalization commitments (Severino and Menon 2013). These problems have been compounded by the global tendency to liberalize services last (Hill and Menon 2013).

Nevertheless, liberalizing services trade could be improved by concentrating on groups of services rather than focusing on isolated individual sectors; prescribing standard rules governing licensing and other regulatory regimes; and replacing built-in flexibilities under the ASEAN-X formula with specified dates for compliance (Nikomborirak and Jitdumrong 2013).

As with trade in goods and services, unilateral policies have been more significant in liberalizing investment.

A key objective of AFTA was to remove barriers to trade in order to further promote foreign direct investment (FDI) in regional production networks. Prior to the adoption of the ASEAN Comprehensive Investment Agreement (ACIA) in 2008, the scope of the ASEAN Investment Area had placed too much emphasis on intraregional FDI—prioritizing investment facilitation and provision of national treatment among ASEAN partners. This strategy made very little sense, given that the bulk of FDI in the region comes from non-ASEAN economies like the US, Japan, EU, and increasingly the PRC and the Republic of Korea. ACIA and the Economic Blueprint seem to have gone some ways toward fixing this by covering a wider range of provisions on investment liberalization, MFN and national treatment, investment protection, facilitation and cooperation, and promotion and awareness (Aldaba and Yap 2009). Nonetheless, as with trade in goods as well as in services, unilateral policy initiatives seem to have played the more significant role with investment liberalization. Key challenges also remain, foremost being the removal of domestic hurdles that continue to hamper ASEAN integration. To increase investments, priority must be given to improving the business climate and reducing the cost of doing business in each country (Bhaskaran 2013). The real impact of the AEC on FDI will depend on the extent to which it succeeds in presenting the region to potential investors as a single market and production base.

Attempts to liberalize skilled labor within ASEAN could be positive if it results in greater mobility of professionals within the region, reducing skill gaps.

Unlike reforms relating to trade and investment, policies relating to labor flows remain piecemeal. Although ASEAN labor markets are becoming increasingly integrated, policies relating to cross-border movement of people continue to lag behind. The policy gaps relating to labor flows exist in both sending and receiving countries, and both must be addressed. Therefore, the policy challenges relate to the governance of labor mobility, the protection of migrant workers, and harnessing labor migration for economic development.

Although ASEAN has signed several formal accords since 2000—including the January 2007 ASEAN Declaration on the Protection and Promotion of the Rights of Migrant Workers—implementation has been lackluster (Hill and Menon 2012). However, intra-ASEAN labor flows occur independently of these arrangements and are largely market-driven—dictated by large inter-country differences in labor supply and demand, wage differentials, and porous borders.

The overwhelming share of both recorded and unrecorded labor flows within ASEAN is in low- and semi-skilled labor. This extends from domestic helpers in Malaysia and Singapore (from the Philippines and Indonesia), to agricultural labor in Malaysia (from Indonesia) and Thailand (from CLM countries) to various service sectors such as construction in Malaysia and Singapore and food processing in Thailand. It is unclear what impact the AEC will have on overall flows as it only deals with movement of skilled labor. There are clear difficulties and sensitivities in liberalizing unskilled labor flows given the diversity within ASEAN. But it remains an open question as to how an economic community, however defined—or a single market and production base—can be achieved when the majority share of labor is excluded.

Nevertheless, the attempt to liberalize skilled labor within ASEAN could be a positive move if it results in great mobility of professionals within the region that reduce skill gaps. This is being pursued by negotiating ASEAN Mutual Recognition Arrangements (MRAs) in seven occupational groups—engineering, nursing, architecture, surveying, medical practice, dental practice, and accountancy. The approach being taken has generally been bilateral, given the complexities involved. Although MRAs underscore ASEAN's commitment to the principle of regional economic integration, most are riddled with loopholes under the general cover of "flexibility," and some of them have not been ratified by all ASEAN member states (Severino and Menon 2013). Furthermore, an MRA does not provide for unrestricted free flow of foreign professionals, because relevant domestic regulations and market demand conditions still apply. It remains to be seen how much these MRAs will add to skilled labor movements that were already taking place bilaterally.

As ASEAN members prefer to run disputes through the WTO rather than ASEAN's Enhanced Dispute Settlement Mechanism (EDSM), the mechanism must be strengthened while dispelling perceptions its decisions are not rules-based.

The principles for dispute settlement are set out in the 2004 ASEAN Protocol on EDSM and the 1996 ASEAN Protocol on Dispute Settlement Mechanism—patterned after the WTO Understanding on Dispute Settlement. To date, however, ASEAN members have yet to activate the protocol. This failure is due to many factors. For one, not all unresolved disputes as defined in the Protocol adopted in 2010 are "referable" to the ASEAN Summit, and ASEAN's EDSM is currently plagued by weak financial and institutional support. Not surprisingly then, ASEAN members would rather refer their trade and investment disputes to the WTO than to ASEAN bodies provided for in the ASEAN Charter and other agreed ASEAN instruments like the EDSM. In addition, the traditional ASEAN non-confrontational way of settling disputes has allowed the rare intra-ASEAN trade dispute to be settled amicably, without proceeding to formal panel hearings (Hsu 2013).

To encourage its use, ASEAN must first and foremost strengthen the EDSM and dispel the notion that its decisions are not rules-based. There is also a need to provide assistance to members requiring help so that they are well-equipped to effectively use the EDSM (Hsu 2013). This is a major challenge given ASEAN's penchant to settle disputes in the non-confrontational "ASEAN way."

Pillar 2: Competitive economic region

Competition policy and intellectual property rights (IPR) protection are difficult areas of reform, and questions remain as to what extent a regional approach, as opposed to a national or multilateral one, can be more effective.

Two of the key components of the AEC's second pillar are competition policy and intellectual property rights (IPR) protection, both of which aim to improve a country's business environment. Both promote price, product and production-process competition, thus lowering production and transaction costs, and encouraging more efficient allocation of resources and improved consumer welfare. Effective IPR protection also helps foster competition among firms, leading to greater product and process innovation, making consumers better off. They are also designed to better the business climate in attracting FDI inflows (Severino and Menon 2013).

These are difficult areas of reform, and questions remain as to whether a regional approach is better than a national or multilateral one. Take the case of IPR. Removing barriers generally occurs under the presumption that liberalization is mutually beneficial. But in the case of intellectual property, countries that do not innovate but adapt or even copy innovations elsewhere without offering at least some compensation to the originator could end up worse off—as a result of rules that protect IPR (Bhagwati 1994; Lawrence 1996). Given the lack of direct incentives, the multilateral approach has one key advantage over the regional one—the ability to trade concessions across disparate interests. A multilateral approach can weigh up the costs to non-innovating countries (such as most ASEAN members) of conceding on IPR protection, against the benefits from increased market access in areas that benefit them—such as in agriculture, textiles, and apparel (Maskus 1997).

Nevertheless, there are potentially considerable benefits regionally from the harmonization of standards, particularly in developing a regional market.

Harmonizing standards has one major problem—implementation and enforcement. For a long time, enforcing intellectual property rules, in particular, has been a major concern with respect to developing countries (Konan et al. 1995). Although the AEC Economic Blueprint bears the commitment to integrate the regional economy, both competition policy and IPR protection are essentially national in application. In light of widely different levels of development among ASEAN members and their often clashing national interests, cooperation and coordination—rather than uniformity in competition and IPR rules—are likely to be more achievable as goals. Even these, however, will likely take considerable time (Lall and Ian McEwin 2013).

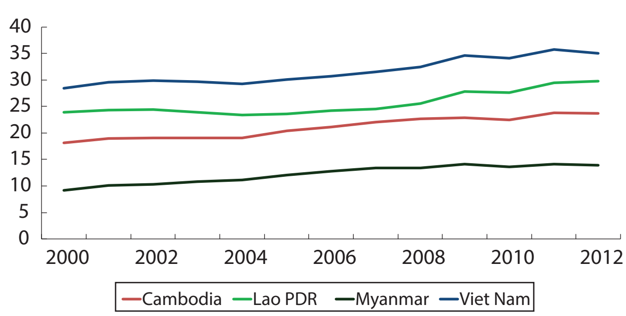
Pillar 3: Equitable economic development

Notwithstanding recent achievements, there is a long way to go before the development gap within ASEAN narrows substantially.

The third pillar of the AEC Economic Blueprint is Equitable Economic Development, which aims to address the development divide and accelerate integration of CLM within ASEAN. There is evidence that the process of convergence has begun as newer members begin to catch up to the economic conditions in the original, higher-income ASEAN states. Strong rates of economic growth since the 1990s—driven by trade, investment, and other market reforms—have reduced differences in per capita incomes (**Figure 36**). This rapid growth has also been associated with dramatic reductions in poverty. Still, much more needs to be done before the development divide is substantially narrowed (Menon 2012).

Under the AEC Blueprint, subregional arrangements such as the Initiative for ASEAN Integration (IAI) have been identified as key components supporting the third pillar. The lack of disaggregated data makes it difficult to discern how much success or failure can be attributed solely to subregional initiatives. But an assessment of the IAI and four subregional zones (SRZs)—the Singapore–Johor–Riau (SIJORI) zone, the Greater Mekong Subregion (GMS), the Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT), and the Brunei Darussalam–Indonesia–Malaysia–Philippines East ASEAN Growth Area (BIMP-EAGA)—affirms that subregional zones can potentially help reduce development gaps and improve connectivity across national boundaries. To fully harness the potential of these initiatives, emphasis should be placed on developing the newer and less-developed ASEAN members with innovative ways of financing, such as public-private partnerships (Pomfret and Das 2013).

Figure 36: GDP per capita of the CLMV as a share of Thailand's GDP per capita (PPP, current international $)



Lao PDR = Lao People's Democratic Republic, PPP = purchasing power parity.
Source: ADB calculations using data from *World Economic Outlook April 2013,* International Monetary Fund.

Nonetheless, the reality is that neither the IAI nor other subregional initiatives will have the resources, or the ability, to fully address the development divide. While these can play a part, the solution must come from broader economic reforms. This will necessarily involve adoption of policies that promote rapid economic development and economic convergence. Among other things, investing in social infrastructure, especially in education and health—to produce a more productive workforce, to increase capital inflows and labor absorption using comparative advantage, and to redress asset inequality and enhance incentives for productivity in agriculture—are all necessary conditions. They need to be complemented with the other elements of an inclusive growth strategy in order to ensure convergence (Menon 2013b).

Pillar 4: Integration into the global economy

Throughout the 1980s and 1990s, ASEAN members embarked on a combination of multilateral and unilateral measures to reduce barriers to trade in goods, services, and investments. Since 2000, however, there has been less progress on multilateral liberalization, and domestic reform has slowed significantly as a result. One partial response has been the proliferation of ASEAN FTAs (ADB 2013).

ASEAN FTAs have done little to promote regional economic integration or integration with the wider Asian or the global economy.

A closer look at ASEAN FTAs leads to several conclusions. One is that the shift from unilateral liberalization to preferential liberalization has not led to further external opening or domestic reform (WTO 2011). Another is that the FTAs are "weak" and "trade-light." In other words, while the agreements commit the parties to eliminating tariffs on trade between themselves, they do not effectively address regulatory barriers and other NTBs, like product standards and MRAs, services, investment, intellectual property rights, government procurement, or the movement of business people—which are all more important than tariffs for regional economic integration.

Thus, the FTAs that ASEAN has concluded hardly promote regional economic integration or ASEAN's integration with the wider Asia or the global economy (Sally 2013; Hamanaka 2012).

These findings are significant, particularly in light of two major FTAs in the offing: the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP).

Although the TPP's agenda is ambitious and wide ranging, it remains to be seen what can be agreed on, given the diversity of its membership.

The TPP involves four ASEAN members—Brunei Darussalam, Malaysia, Singapore, and Viet Nam—and features an agenda that is wide-ranging and demanding, more so than the RCEP or other FTAs. It excludes most ASEAN members as well as the PRC and the Republic of Korea, and a significant increase in Asian membership is needed before it could be considered a serious alternative to the RCEP. More generally, without participation of these economically important countries, there is serious concern that the current TPP membership satisfies the critical mass criterion. The same concern applies to the current makeup of RCEP.

The need to provide exemptions, or "carve outs," to avoid a collapse in negotiations also raises concerns over the final form the TPP will take. The secrecy surrounding the negotiations makes it difficult to assess progress, but—from what is known—there is the risk of degenerating into a series of loosely tied bilateral deals. Indications are that the two largest TPP members—the US and Japan—are proceeding along bilateral lines, threatening the demanding single-undertaking approach the TPP is supposed to adopt.

Although the number of countries involved in these negotiations is much lower than at the WTO, for instance, it does not translate to a commensurate reduction in diversity in terms of disparate interests. These interests often conflict, especially in a context where the agenda is far more ambitious than any other proposed thus far. The recent round of negotiations that took place in Brunei Darussalam in August 2013 was reported to have made very little progress, highlighting the difficulties being faced as the TPP moves toward finding common ground on the more difficult issues.

With RCEP, there is a real risk of a "race to the bottom", where the lowest common denominator prevails in order to secure consensus.

Although RCEP membership is supposed to be based on open accession, it starts with the ASEAN members and the "Plus Six", all of whom have bilateral FTAs with ASEAN (the ASEAN+1 FTAs).[27] Although the ASEAN Framework on the RCEP was formally endorsed in November 2011, negotiations began only in May 2013. Now underway, no new members will be allowed until negotiations are completed. Details remain sparse, but from the RCEP's Guiding Principles it is clear that it will add to, rather than replace, existing FTAs. Again, the target completion date is 2015. But this is highly unlikely given the difficulties noted earlier of folding multiple, disparate agreements into one that is region-wide.

RCEP's Guiding Principles also includes a "flexibility" clause, stating that it "will include appropriate forms of flexibility including provision for special and differential treatment (SDT), plus additional flexibility to the least-developed ASEAN member states…" As already seen, flexibility can both be a boon and bane. While it can help break deadlocks and protect disparate self-interests, it can also limit change or curtail progress in achieving greater liberalization. With RCEP, there is also the real risk of a "race to the bottom", where the least common denominator prevails to secure consensus (Menon 2013b). Were this to occur, RCEP would simply add to the tangled regional trade landscape.

Between Now and 2015: Pursuing Reform in an Era of Rising Uncertainty

The deadline for realizing the AEC is December 2015. Merely 2 years away—and given all the remaining obstacles and challenges—fully achieving the AEC by the end of 2015 seems highly improbable. On top of this, a new challenge has appeared as a result of recent events. The financial turmoil that affected several ASEAN countries (and beyond)—following capital outflows in anticipation of the US Federal Reserve's tapering of quantitative easing—poses a new challenge to meeting the AEC timetable. Within ASEAN, Indonesia was most

[27] The "Plus Six" referes to Australia, the PRC, India, Japan, the Republic of Korea, and New Zealand.

directly affected (as of September 2013), with significant currency depreciation and a decline in stock market prices. Other ASEAN countries have not been immune—with Thailand and Malaysia also affected. Both, like Indonesia, have significant and deteriorating fiscal deficits. Malaysia's current account surplus has narrowed significantly, while the deficits in Indonesia and Thailand have widened.

Progress in the reforms needed for regional integration are usually hampered during periods of heightened risk and uncertainty, as preserving employment and short-term growth can override longer term objectives.

Apart from slowing the pace of reform, market uncertainties can wind back the process if countries opt for increasing restrictions in the short term. This was played out to varying degrees across ASEAN in the immediate aftermath of the 2008/09 global financial crisis. A joint WTO–Organisation for Economic Co-operation and Development–United Nations Conference on Trade and Development (WTO–OECD–UNCTAD 2013) assessment to the G20 and by the European Commission (2013) both point to a rise in various forms of trade restrictions together with a slowdown in liberalization. Both reports cite several countries—particularly Indonesia and Brazil—as continuing to shield some domestic industries from foreign competition, to the disadvantage of their consumers and other industry sectors. The report to the G20 cites an increase in the number of trade restrictive measures from 71 during May–October 2012 to 109 during October 2012–May 2103, with Indonesia in the top 4 countries accounting for the increase (see Table 3). This jives with a longer term trend of a rise in non-tariff protectionist measures, which the Global Trade Alert database reports rose gradually from 105 in 2009 to 330 in 2012.[28] It should be noted, however, that these assessments precede the recent market turmoil in Indonesia, which happened after May 2013.

While a protectionist backlash may be the first response to rising uncertainties, the aftermath of the 1997/98 Asian financial crisis suggests that turmoil can boost regional integration in the medium to longer term.

The challenge lies with containing any short-term knee-jerk reaction, before a more thought out response kicks in after the dust settles. Should economic conditions deteriorate further, it is likely that progress toward realizing the AEC will slow. This will mean even less of the 2015 AEC targets will be met. But if recent experience is any guide, the prospects for the AEC beyond 2015 may even be enhanced, if again regional turmoil leads to increased efforts to bolster reforms and strengthen regional cooperation and integration.

AEC 2015 and Beyond: Reconsidering "Business as Usual"

With the prospects for completing the AEC by 2015 highly unlikely, it would be best to view 2015 as a milestone rather than a "must-do" target.

In light of the many obstacles and challenges that remain—compounded by recent events that increase financial risk and uncertainty—it is unlikely to meet all of its targets by the end of 2015. Therefore, it is best to view 2015 as an important milestone, and just one—but major—step in establishing an integrated ASEAN economic community. The commitments to an AEC should continue to denote ASEAN members' political conviction that regional economic integration will help improve the lives of its citizens. And it should continue to signal to the international community that ASEAN is open for business—profitable for trade and investment—and a market that intends to compete globally. However, making it happen means not only strengthening implementation to close remaining gaps, but even more important, it will mean reconsidering existing institutional mechanisms for creating an AEC.

[28] Global Trade Alert. http://www.globaltradealert.org/

The success or failure of the AEC ultimately lies in the hands of national decision-makers in charge of implementation.

Although often constrained by powerful domestic political and economic lobbies, ASEAN's leaders need to ensure those in charge of implementing AEC commitments have the power to do so. As Bhaskaran (2013) argues, ASEAN "must be realistic in appreciating that the political obstacles towards full-blown integration will take time to dissipate." Toward this end, there may be merit in focusing on "bite-sized" subregional integration, such as the GMS Program, for possible expansion or replication.

The flexibility engrained in ASEAN cooperation and institutional arrangements should not become a pretext for non-compliance, undermining the predictability that investors look for in any country or region.

At present, there are no means to compel compliance with AEC commitments. There are a number of ways this weakness can be addressed. One is to reduce "ambiguities" through realistic time-bound commitments, while maintaining the flexibility and consensus decision-making that protects the sovereignty and autonomy ASEAN members insist upon. Another is to improve the effectiveness of existing monitoring and feedback mechanisms through independent and better information. The ASEAN Secretariat will also have to be strengthened and streamlined (Nesadurai 2013).

Giving AEC commitments more teeth is important. But ASEAN also must face the reality that liberalization thus far has been driven more by market forces than by regional agreements. As Sally (2013) correctly argues, the first priority should be the "revival of the unilateral liberalization of trade and FDI and behind-the-border reforms, which would be a more realistic step than ambitious new initiatives and grand designs for regional integration, which invariably promise much but deliver little." This observation should give ASEAN pause as it heads deeper into, for example, RCEP negotiations.

Conclusion

ASEAN seeks to create an ASEAN Economic Community or AEC by 31 December 2015. Although it has come a long way toward meeting its own targets, it is likely to fall short by the deadline. How close it gets to these targets will depend on the progress of reforms in the next 2 years. Given ASEAN's diversity, how much is achieved will also vary greatly across member countries. The recent financial turmoil affecting the region presents a new challenge to all members—ASEAN must avoid succumbing to protectionist pressures that arise during periods of uncertainty. If history is any guide, it is likely that reform momentum could slow, at least in the short term. But beyond that, the turmoil could offer a new boost to strengthen integration—as crises have in the past—even as it moves beyond its self-imposed 2015 deadline.

Even if reform proceeds apace toward the deadline, the real test for the AEC will lie in the years beyond. It is one thing to sign agreements, and quite another to implement and enforce them. The success or failure of the AEC ultimately lies in the hands of the national decision- and policymakers who make it happen, and who have the political backing to overcome vested domestic interests that stand to lose from liberalization. Several other factors could complicate the process. Some reforms may require domestic laws to be revamped, while others may require constitutional amendments. The flexibility that characterizes ASEAN cooperation and institutional arrangements could give member states a pretext for non-compliance—and there are enforcement issues. This is the key challenge to be overcome in realizing the AEC as more than a political exercise in solidarity.

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