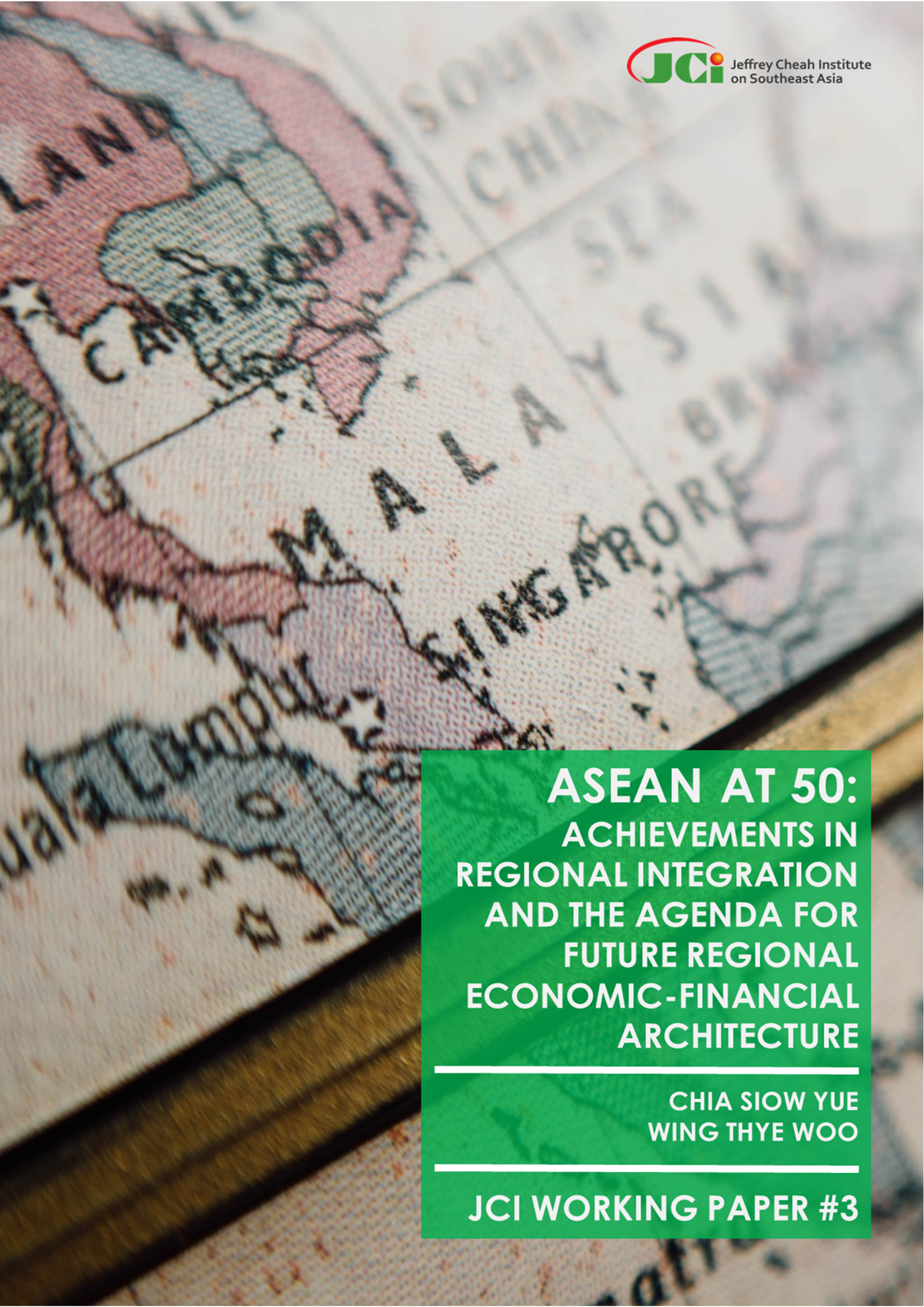

Jeffrey Cheah Institute on Southeast Asia

ASEAN AT 50: ACHIEVEMENTS IN REGIONAL INTEGRATION AND THE AGENDA FOR FUTURE REGIONAL ECONOMIC-FINANCIAL ARCHITECTURE

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ASEAN at 50: Achievements in Regional Integration and the Agenda for Future Regional Economic-Financial Architecture

Chia Siow Yue and Wing Thye Woo

Abstract

Despite large differences on almost every dimension, ASEAN can claim to be one of the most successful regional groupings in the world. ASEAN has largely achieved regional peace and security, despite being caught in the US-China power rivalry in recent years. The ASEAN region has also become one of the largest economies in the world, with a combined GDP that ranks behind only the EU, US, China, Japan, India and South Korea and growth rates well above the world average. ASEAN economic integration has proceeded simultaneously via market-driven regional production networks and global value chains as well as via government-driven trade and investment agreements. The objective of creating an ASEAN Economic Community (AEC) was adopted in 2015; and the next phase of integration, AEC 2025, is under implementation. ASEAN has also entered into regional integration agreements (known as ASEAN+1) with China, Japan, India, South Korea, Australia, and New Zealand, and is in the process of negotiating a mega Regional Comprehensive Economic Partnership (RCEP) agreement with these six partners.

One often-mentioned vision about the future of the financial architecture of ASEAN --that was popular in the period after the Asian Financial Crisis -- was an Asian Economic Union (AEU), where there was comprehensive, deep regional economic integration. The basic question is whether the final realized form of the Asian Economic Union (AEU) would be closer to the European Union (EU) or to the North America Free Trade Area (NAFTA). The return of China as a major global economic power also means that the Renminbi (RMB) could, in the future, attain an international status that is parallel to the USD. The emergence of the RMB as a key international currency, however, does not in any way imply that it would also emerge to be the common currency for East Asia. China in the future would most probably have the same individualistic attitude on China's monetary policy as the United States has at the present toward other countries that have dollarised their economies, which is that the primary concern of US monetary policy is US welfare. Given (1) the NAFTA-like disparity in economic power in AEU in the future, and (2) the absence of policy-induced integration of national labor markets mean that the only stable configuration is the survival of individual East Asian currencies with limited coordination among them in normal times. It therefore appears to us that the many present efforts to promote closer exchange rate cooperation will not succeed in the long-run.

1. Introduction

On 8 August 2017, ASEAN celebrated its 50th anniversary. Fifty years ago, Southeast Asia was a region of conflict and widespread poverty. Fifty years later, the region has achieved peace and security and become a dynamic middle-income grouping. ASEAN is one of the most diverse regional groupings in the world. **Table 1** shows some dimensions of ASEAN diversity.

Table 1: ASEAN: Differences in Size, GDP PC, Trade and FDI Flows 2015

Countries	Land area (000 sq. km)	Population (million)	GDP (billion US$)	GDP per capita (US$)	Goods Trade (US$bill.)	Trade/ GDP ratio (%)	FDI Inflow (US$bill.)
Brunei	5.8	0.4	12.9	30942	9.6	75	0.2
Indonesia	1913.6	255.5	857.6	3357	293.1	34	16.9
Malaysia	330.3	30.5	294.4	9657	375.2	127	11.3
Philippines	300.0	101.6	289.5	2850	128.9	45	5.7
Singapore	0.7	5.5	291.9	52744	663.1	227	61.3
Thailand	513.1	69.0	395.7	5737	417.1	105	8.0
Cambodia	181.0	15.4	18.4	1198	19.7	107	1.7
Laos	236.8	6.9	12.6	1831	6.8	54	1.1
Myanmar	676.6	52.5	65.4	1246	28.1	43	2.8
Vietnam	331.0	91.7	193.4	2109	327.7	169	11.8
ASEAN	4488.8	628.9	2432.0	3867	2269.3	93	120.8

Source: Compiled from 'ASEAN Secretariat, ASEAN Community in Figures 2016'.

First, there is the huge diversity in terms of land area size, population, and GDP. At one extreme is archipelagic Indonesia, with 40 per cent of ASEAN's population and 35 percent of ASEAN's GDP. At the other extreme are the small states of Singapore and Brunei (with the latter being less than 500 thousand people). Second, there is huge diversity in the countries' level of economic development and per capita income. Singapore and Brunei are high-income economies while Cambodia, Laos, and Myanmar are among the world's least developed countries. Third, there is huge diversity in socio-cultural-linguistic terms and historical experiences. Indonesia is the world's largest Muslim state, the Philippines is predominantly Catholic, while mainland Southeast Asia (Thailand, Cambodia, Laos, Myanmar) is largely Buddhist. The ASEAN countries were variously under Dutch, British, French, Spanish and American colonial rule and inherited different legal systems.

Forging a common ASEAN identity therefore becomes an uphill task, especially when the working language of ASEAN had to be English, a language that is foreign to most of its populace. The important outcome from these many different differences in geographical features, economic development, cultural heritage, and historical experiences is that there is a wide spectrum in perception within the ASEAN community about the cost-benefit calculations on economic openness and integration. This helps explain why ASEAN economies continue to show wide divergences in their dependence on international trade and foreign direct investment.

Despite large differences on almost every dimension, ASEAN can claim to be one of the most successful regional groupings in the world. ASEAN has largely achieved regional peace and security, although in recent years it is caught in the US-China power rivalry. The ASEAN region has become one of the largest economies in the world, with a combined GDP that ranks behind only the EU, US, China, Japan, India and South Korea. ASEAN GDP growth rates are well above the world average. ASEAN economic integration has proceeded simultaneously via market-driven regional production networks and global value chains as well as through government-driven trade and investment agreements. The objective of creating an ASEAN Economic Community (AEC) was adopted in 2015; and the next phase of integration, AEC 2025, is under implementation. ASEAN has also entered into regional integration agreements (known as ASEAN+1) with China, Japan, India, South Korea, Australia, and New Zealand, and is in the process of negotiating a mega Regional Comprehensive Economic Partnership (RCEP) agreement with these six partners.

This paper is focused on the economic aspects of ASEAN integration and is structured as follows: Section 2 surveys the main ASEAN milestones. Section 3 provides the conceptual framework for market-driven global value chains and production networks and government-driven regional trade agreements. Section 4 discusses the features, progress, and challenges of the ASEAN Economic Community, and highlights the importance of the Asian Financial Crisis in galvanizing ASEAN desire for collective action to promote the financial resilience of Southeast Asia. Section 5 concludes with some a possible scenario of how the economic and financial architecture of ASEAN would look like in the future.

2. ASEAN Political and Economic Milestones

1967 Bangkok Declaration: A geopolitical milestone

In the 1960s, the political-security environment of Southeast Asia was highly unstable. For example, Indonesia was engaged in 'Konfrontasi' with the new Federation of Malaysia in 1963-65. Malaysia and Singapore had a bitter separation in 1965. There were territorial disputes between the Philippines and Malaysia. And Southeast Asia was battling communist insurgencies within and between states. The non-communist states of Indonesia, Malaysia, Philippines, Singapore, and Thailand (ASEAN5) decided to form ASEAN in 1967, joined by Brunei in 1984 (ASEAN6). The Bangkok Declaration envisioned joint endeavours to accelerate economic growth, social progress and cultural development, regional peace and stability, collaboration, and mutual assistance in economic, social-cultural, and technical-scientific-administrative fields. The Declaration 'was essentially an expression of their determination not to allow their disputes to develop into conflict and their resolve to work together for common purposes'. (Severino 2006, p3)

1976 Bali Declaration of ASEAN Concord

The early ASEAN meetings were attended by their Foreign Ministers, signalling the geo-political focus of ASEAN's first decade. The first ASEAN Summit of Heads of State was held in Bali in February 1976, and it resulted in the Bali Declaration that covered agreements in the political, economic, social-cultural-information, and security spheres. ASEAN agreed to cooperate on the development of basic commodities and industries, and to establish the

ASEAN Preferential Trade Arrangement (PTA) and the ASEAN Secretariat. The Treaty of Amity and Cooperation in Southeast Asia provided for peaceful settlement of intra-regional disputes.

1995-1998: Accession of Cambodia, Laos, Myanmar, Vietnam

Accession of the communist states of Cambodia, Laos and Vietnam and the isolationist Myanmar (CLMV) in 1995-98 united Southeast Asia. However, this also led to a two-tiered ASEAN6 and CLMV, which called for ASEAN programmes to narrow the development gap between the two sub-groups and to help the new members meet their ASEAN commitments.

1992-98: Economic Integration and 1997-8 Asian Financial Crisis

By the early 1990s, both Southeast Asia and the world had changed. ASEAN states were pursuing trade-led and foreign investment-led development. With the subsequent rise of regional production networks, economic complementarity in manufactures and intra-ASEAN trade in parts and components developed. Also, regional economic integration among the rich countries — the European Single Market and the North American Free Trade Area (NAFTA) — further hastened ASEAN's decision on economic integration to meet the challenges of export and investment competitiveness, leading to the 1992 ASEAN Free Trade Area (AFTA), 1995 ASEAN Framework Agreement on Services (AFAS) and 1998 ASEAN Investment Area (AIA). The Asian Financial Crisis of 1997-98 further strengthened ASEAN's resolve to remain competitive in international trade and foreign investment, and to become more resilient financially through economic integration and financial coordination within ASEAN+3 programs.

The 2001 Mid-Term Review of Hanoi Plan of Action highlighted some of the implementation problems of AFTA, AFAS, and AIA. First, the commitments to liberalization and cooperation were weak because of poor awareness of their benefits. Second, there was bureaucratic inertia and time-consuming consultations among stakeholders. Third, for some countries, inadequate technical capacity and financial resources handicapped implementation.

2007-2015: ASEAN Charter and ASEAN Community

The ASEAN Charter in November 2007 created a legal personality and marked the institutionalisation of ASEAN. The Charter provided for an enhanced role for the ASEAN Secretariat, promotion of a 'people-oriented' ASEAN and adoption of the principle of 'shared commitment and collective responsibility'. In 2003, ASEAN agreed to deepen economic integration, driven by concerns over export and FDI-competitiveness in the wake of the Asian Financial Crisis and the economic rise of China and India. The ASEAN Community was established with the three pillars of the ASEAN Economic Community (AEC), ASEAN Political-Security Community (APSC), and the ASEAN Socio-Cultural Community (ASCC). The AEC would be realized by 2020, but this was subsequently advanced to 2015 and a Blueprint and Roadmap was developed for 2007-2015.

2016-2025: Towards AEC 2025

Although the AEC was declared on 31 December 2015, it was still a work-in-progress. At the 27th Summit in late November 2015, ASEAN released the AEC 2025 Blueprint which charted new directions for the next decade. ASEAN eschews following the EU model towards deeper integration and supra-national mechanisms. Instead, it emphasises digitalisation and inclusive and sustainable development.

3. Conceptual Framework of Economic Integration Via Government-Driven RTAs and Market-Driven GVCs and GPNs

In recent decades, governments have signed increasingly deeper regional and bilateral trade agreements (RTAs) while private firms (particularly multinational corporations) fragment production geographically across borders through global value chains (GVCs) and Global Production Networks (GPNs). These twin phenomena reinforce each other, from the need to internalize cross-border policy spillovers to the benefits of stronger commitments in policies that affect GVC participation. The RTAs go beyond traditional trade in goods to encompass trade in services, investment, and various behind-the-border regulatory barriers. The rise of GVCs and GPNs altered the character of international trade with the dramatic rise of trade in parts and components.

3.1 Government-driven RTAs

The traditional theory of economic integration began with Jacob Viner's (1950) analysis of customs unions, distinguishing between positive trade creation and negative trade diversion effects of changes in import tariffs. Trade creation occurs when trade shifts from a high-cost supplier member country to a lower-cost supplier member country, thus raising country welfare. Conversely, trade diversion occurs when supply shifts from a lower-cost non-member country to a higher-cost member country. Viner's static effects of economic integration were subsequently expanded to embrace dynamic effects arising from economies of scale, technological change, competition, productivity growth and investment growth. And under Lipsey and Lancaster's (1956) theory of the second best, it was argued that while the best policy option is free trade, this option is not open in the real world of imperfect competition and global trade with barriers.

The following conceptual stages of economic integration is usually attributed to Balassa (1961) and based largely on the European experience:

- *Preferential Trading Arrangement (PTA):* Sectoral trade liberalization between countries, such as the European Coal and Steel Community of 1945-1957.
- *Free Trade Area (FTA):* Member countries agree to eliminate among themselves the trade barriers on goods (both tariffs and non-tariff barriers), while continuing with trade barriers against the rest of the world. Increasingly, FTAs extend beyond trade in goods to encompass trade in services, investment liberalization and facilitation, as well as behind-the-border measures of government procurement, competition policy, intellectual property rights and labour and environmental standards. The FTA is the most common form of economic integration notified to the GATT-WTO.
- *Customs Union (CU):* In addition to trade liberalization among member states, a CU also adopts a common external tariff on goods imported from the rest of the world, such the European Community formed in 1957.
- *Common Market:* In addition to free movement of goods and services, a common market also encompasses free movement of labour and capital among member countries, such as the EU Single Market in 1993.
- *Economic Union:* This is the most advanced stage of economic integration, where the monetary and fiscal policies of member countries are harmonized and sometimes even

completely unified. In January 1999 eleven members of the EU formed the Eurozone single currency area with extension of membership in later years.

Apart from the above typology, economic integration can also be typified as 'shallow' or 'deep'. Shallow integration focuses mainly on trade liberalization through tariff elimination and facilitation. Deep integration focuses as well on investment liberalization and facilitation, free movement of labour and capital, and coordination and harmonization of regulatory policies. Deep integration also requires supra-national implementation mechanisms. Issues of protectionism and loss of sovereignty make most countries hesitant on deep integration.

RTAs have spread from Europe to North America and Australasia and increasingly to developing countries. The number of such agreements on goods and services (including bilaterals) notified to the WTO under GATT Article XXIV, GATS Article V and the Enabling Clause stood at 271 by end-2016, reflecting both frustrations with the multilateral trading system under GATT-WTO and appreciation of the potential benefits of economic integration. These benefits can be grouped into four categories:

- *Trade benefits*: Economic integration leads to reduction in trade costs, improved access to goods and services, and efficiency gains from specialization and economies of scale.
- *Economic development, GDP and employment gains:* As trade liberalization leads to market expansion and more technology and investment flows, it expands market opportunities and productivity gains and hence growth in GDP and employment.
- *Political cooperation benefits*: With enhanced interdependence and dialogues among the political and bureaucratic elites, there is political cooperation on conflict prevention and resolution such as in the EU and ASEAN.
- *Other public goods benefits:* These include cooperation on issues such as the environment, climate change, migration, regional natural disaster management, and risks of reversion to isolationism and protectionism.

The ongoing rhetoric on globalization, British withdrawal from the EU (Brexit) and US President Donald Trump's 'America First' policy also highlights concerns over the negative effects of globalization and regionalism:

- *Issue of regionalism versus multinationalism*: Economists and other scholars continue to debate whether regionalism is leading to a more fragmented world economy or encouraging the extension of the existing global multilateral trading system. Many also counter-argue that the WTO-led world does not represent global free-trade but global managed-trade and deep RTAs may complement the global system as they enable coordinating or harmonizing policies not politically feasible at the global level.
- *Issue of lack of inclusiveness and growing inequality:* It is argued by politicians and many in civil society that the forms of regional integration in practice have actually hollowed out and displaced economic sectors, local firms and local labour, and worsened social inequality.
- *Issue of loss of national sovereignty:* An RTA, particularly at an advanced stage, is likely to lead to major loss of policy sovereignty for its signatories. Sovereignty is a key issue in the UK decision to leave the EU. However, some counter-argued that the concept of sovereignty is becoming blurred in this highly interconnected world.

- *Issue of downside of economic interdependence:* As signatory countries become increasingly interdependent in an RTA, any disruption of trade or finance in one part could severely disrupt other parts of the region.

3.2 Market-driven GVCs and GPNs

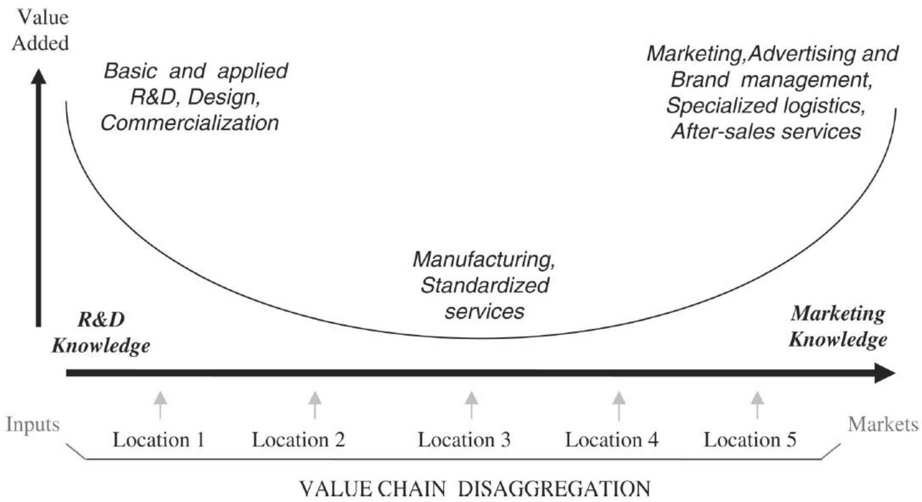
Increasingly modern manufactured products are the result of complex global production arrangements (GVCs and GPNs) which are market-driven. They refer to the breaking up of production processes into fragmented segments which can be carried out in different cross-border locations and eventually coordinated for assembly into final products. For example, many smart phones are designed in the US, have sophisticated inputs sourced from South Korea, Taiwan and ASEAN, are assembled in China, and are then marketed (with after-sale service) in Europe and US.

The 1980s information technology revolution enabled production processes to be 'sliced' into segments such as design, parts procurement, assembly and distribution, and relocated off-shore to be more efficiently performed. Jones and Kierzkowski (1990) provide a model of outsourcing and set out the factors that affect the degree and form of the fragmentation of production activities. First, is the improvement in productivity caused by the division of labour. Second is the increase in fixed costs due to the need for coordination between the production units in different locations. The least costly form of production will switch from the traditional method to outsourcing, when two additional aspects have to be considered. First, the more diverse the production factor costs between countries, the more productivity will rise when outsourcing takes place according to comparative advantage. Second, coordinating production units in different countries is costlier than within the same country, due to import tariffs, customs clearance, regulatory standards, and communication barriers of language, legal system, and business ethics. Thus, a global production arrangement depends on three factors, namely, the size of the targeted market to enable efficient international division of labour, connection costs of production units in different countries, and factor costs in the countries in the production network.

The theoretical foundations of product fragmentation were followed by empirical observations and analyses of trade in intermediate goods, and trade in tasks made possible by recent availability of the OECD-WTO Trade in Value Added (TiVA) database. The Global Value Chain Development Report 2017 develops 3 indexes to characterize the nature of GVCs: First, a *production length index* to measure the average number of production stages and complexity of the value chain, Second, a *participation index* to measure the intensity of a country-sector's engagement in GVCs. Third, a *position index* for the location of a country-sector pair on a GVC. The Report characterizes cross-border production-sharing patterns and GVC activities for 35 sectors and more than 40 countries over 20 years.

The international division of labour in the GVC and GPN is graphically represented by a Smile-Curve as shown in Diagram 1 below.

Diagram 1: International division of labour in the GVC and GPN



Source: Ye, Meng and Wei (2015)

- *Research and design activities* at the extreme left of the Smile-Curve: These are knowledge-intensive, high-value-added activities and tend to be carried out in more advanced economies such as US and Japan.
- *Manufacturing and assembly standardised activities* at the mid-section of the Smile-Curve: These are low-wage activities using mainly low-skilled workers. Asian developing countries are found in this segment, with China as the main assembly node. China's competitive strengths lie in its ample supply of relatively cheap and trainable labour as well as ample supply of mid-level supervisory manpower and trade liberalisation and infrastructure provisions in special economic zones.
- *Marketing, logistics, and after-product service activities* at the right-end of the Smile-Curve: These are also high value added, and tend to be carried out by advanced economies.

Dependence on international division of labour based on GVCs and GPNs raise distributional concerns for both the advanced and developing economies. For the advanced economies (as typified by the US under the Trump Administration), there is concern that manufacturing is being hollowed out as MNCs increasingly locate production offshore and American low-skilled workers become unemployed or suffer wage stagnation and decline. Conversely, developing countries that are integrated into GVCs and GPNs worry about being trapped in the low-value added segment and being unable to upgrade.

For developing countries that are not yet integrated into GVCs and GPNs, their primary concern is to gain entry in order to diversify their export structure and industrialize without developing the capacity for manufacturing whole products. So far only a small number of developing economies have succeeded, with China the shining example. Factors that are favourable for entry into GVCs and GPNs include the following: first, geographical proximity to the US hub, the China-Japan-South Korea hub, and the Western Europe hub. Second is competitive production costs. These do not necessarily imply low wages, as poor labour productivity and other costs in the production process would offset any low-wage advantage. Third is competitive trade costs. In sectors with complex value chains, such as motor vehicles, computers, and machinery, and requiring frequent border crossings of parts and components, weak transportation links, tariffs and inefficient customs clearance, and bureaucratic red tape can severely impede trade. Strategies to overcome these barriers would include trade and investment liberalization policies, trade facilitation measures, including physical and ICT infrastructure development. Many developing countries have addressed these problems by establishing SEZs, pending economy-wide improvements and participate in RTAs.

4. ASEAN Economic Integration and Cooperation 1967-2017

4.1 Market-driven economic integration through production networks

Since the 1980s, production networks have expanded rapidly in ASEAN and the broader East Asian region in response to the following: first, wide intra-regional differences in wage and labour productivity levels led to divergent cost locations for different segments of the value chain. Second, widespread adoption of outward-oriented development strategies resulted in trade and investment liberalization unilaterally as well as under FTAs. Third, improved physical and communications infrastructure, logistics, and customs administration lowered trade costs and facilitated trade and investment flows. Fourth, from the 1990s GVCs and GPNs in the region have also been facilitated by trade and investment liberalization and facilitation (including customs, standards harmonization, logistics, and transport development) under AFTA, AFAS, AIA, and the AEC as well as industrial complementation under AICO which have encouraged FDI by MNCs. GVCs and GPNs have spread from the more advanced ASEAN members to the rest of ASEAN as the former moved up the value chain and the latter took over the more labour-intensive segments.

The regional division of manufacturing production and export in the East Asian region appears as follows: China, Japan, and South Korea are the home countries for production networks in machinery and parts; China has become the regional assembly base; Singapore, Thailand, Malaysia, and Philippines are initial ASEAN exporters of machinery parts and components as they implemented policies that encourage inflows of MNC investments, effective absorption of new production technologies, and growth of local supporting suppliers and globalized links.

Table 2 shows trade in value added (VA) for the ASEAN5, Cambodia, and Laos. A country's gross exports are decomposed into 3 domestic VA content and one foreign VA content. First, domestic VA sent to consumer economy (and embodied in final or intermediate goods or services directly consumed by importing economy). Second, domestic VA re-imported in the economy outlines the domestic VA of exported intermediates that is sent back to the economy of origin as embodied in other intermediates and used to produce exports. Such a VA round-trip between two economies highlights the domestic VA content present in an economy's exports. Third, domestic VA sent to third economies, that is, domestic VA contained in intermediates exported to the first economy that re-exports them to a third economy as embodied in other goods and services. Fourth, VA content of exports corresponds to the VA of inputs that were imported in order to produce for export, that is backward GVC participation.

Table 2: ASEAN and China trade in value added and intermediates

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Cambodia	Vietnam	China
Value added component of gross exports (% share in total gross exports) 2011								
*domestic VA sent to consumer economy	56.4	39.3	49.0	38.3	45.5	51.3	47.7	51.3
*domestic VA re-imported in the economy	31.5	19.8	27.4	19.9	15.4	11.9	15.0	15.6
*domestic VA sent to third economies	0.1	0.3	0.0	0.1	0.1	0.0	0.1	1.0
*foreign VA content of exports	12.0	40.6	23.5	41.7	39.0	36.8	36.3	32.1
Total trade in intermediates 2013 or 2014 (% of total)								
*merchandise exports in intermediates	66.1	69.3	29.1	65.9	51.5	31.5	31.4	41.7
*merchandise imports in intermediates	70.1	70.8	67.1	68.5	67.1	70.4	74.9	69.5
*intermediate commercial services exports	31.3	25.9	71.5	27.2	17.5	8.2	8.8	38.3

Source: WTO online country data on trade in value added and global value chains

Table 3 and **Diagram 2** also show the *GVC participation index* with two components reflecting the backward and forward linkages of an economy with its foreign trade partners. Among the ASEAN economies, Singapore and Malaysia have participation indexes of over 60 percent while Indonesia and Cambodia have less than 50 percent, as compared with 47.7 percent for China and an average of 48.6 percent for developed economies and 48.0 percent for developing economies. The *forward participation index* corresponds to 'Domestic VA sent to third economies' in Table 2 and captures the domestic VA contained in inputs sent to third economies for further processing and export through the value chain. This is the supply side in the GVC participation index. Among the ASEAN economies, Indonesia has the highest and Philippines the second highest forward participation index. The *backward participation index* corresponds to the 'Foreign VA content of exports' in Table 2 and is the sourcing side in GVCs, where the economy imports intermediates to produce exports. Singapore and Malaysia have the highest backward participation index.

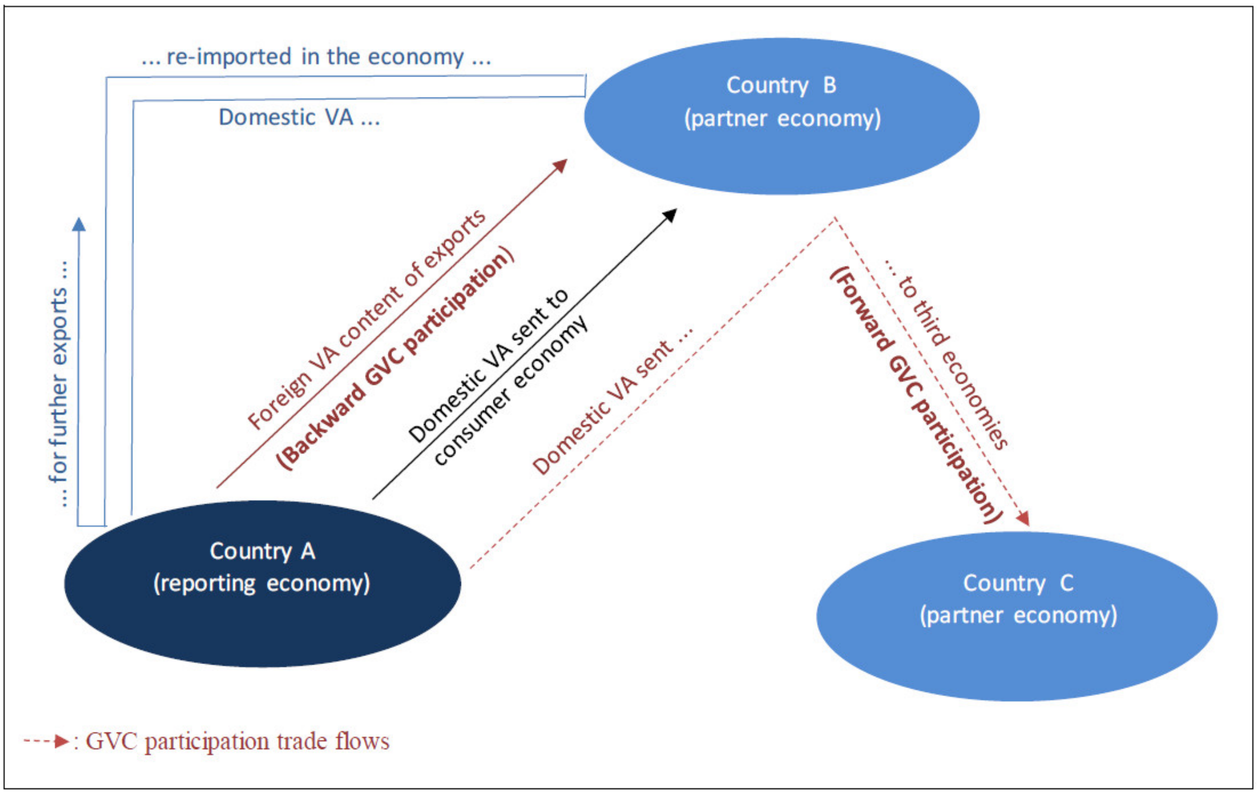
What roles do FTAs play in the rapidly-expanding network-trade in the ASEAN region? Trade and investment liberalization and facilitation under AFTA, AFAS, AIA, and AEC as well as industrial complementation under AICO have encouraged FDI by MNCs and the location of multi-plants in the ASEAN region, the most apparent being in the electronics and automotive sectors in the ASEAN5 and in the textiles and garments sector in Cambodia and Vietnam. ASEAN investment liberalization, facilitation, and protection have attracted MNCs to establish operations in different ASEAN locations while improvements in ASEAN customs and standards harmonisation have facilitated trade flows. More particularly, production networks are spreading from the more advanced ASEAN economies to the less developed economies of Vietnam and Cambodia. Laos remains hobbled by the lack of ready access to transportation and Myanmar by the need for economic reforms. ASEAN must further build upon its production networks. The more advanced economies of Singapore, Malaysia, and Thailand will need to deepen their competitive advantage in existing production networks and industrial clusters and relocate some of their labour-intensive segments to ASEAN economies with lower wage and production costs.

Table 3: ASEAN and GVC participation 2011

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Cambodia	Vietnam	China
GVC participation index (% share in total gross exports)								
*total GVC participation	43.5	60.4	50.9	61.6	54.3	48.7	52.3	47.7
*forward participation	31.5	19.8	27.4	19.9	15.4	11.9	16.0	15.6
*backward participation	12.0	40.6	23.5	41.7	39.0	36.8	36.3	32.1

Source: WTO online country data on trade in value added and global value chains

Diagram 2: Value added components of gross exports and GVC trade flows



Source: Online WTO-OECD TiVA database

4.2 The 1997 Asian Financial Crisis as Impetus for Asian Economic and Financial Integration

In retrospect, the Asian financial crisis of 1997-1998 gave a huge boost to the impetus towards Asian economic and financial integration. The yearn for greater economic integration in post-crisis Asia was due as much as to the consequences of the 'financial typhoon' which appeared in the Gulf of Siam on July 2, 1997, as it was due to the causes of the 'typhoon' and to the responses of the international financial institutions and the United States and Western Europe.

Numerous post-mortems have been performed on the Asian financial crisis.[1] Each autopsy report typically contained the following three hypotheses, with each work differing in emphasis on the importance of individual hypothesis in each country:

- *Hypothesis 1 – Prolonged Economic Mismanagement*: Prior to July 2 1997, crony capitalism and economic mismanagement in the East Asian economies had loaded their national financial systems with weak loans, hence rendered their continued high growth unsustainable. These Asian economies imploded for the same reasons the Soviet bloc economies had imploded in the early 1990s. Their industries were not viable without various forms of subsidies (e.g. directed credit, protection), and the aggregate subsidy had reached a level in 1997 that the state could no longer provide.

- *Hypothesis 2 – Financial Market Panic*: International financial markets, just like domestic financial markets, are susceptible to bouts of mania, panics, and crashes, causing them to help stoke booms and busts in their clients' performance (which in the periods of irrational exuberance are often dignified with self-congratulatory books with titles like 'The Asian Miracle' and 'Japan as No. 1'). Paul Volcker (1999) has put the matter well:

  > 'International financial crises, I might even say domestic financial crises, are built into the human genome. When we map the whole thing, we will find something there called greed and something called fear and something called hubris. That is all you need to produce international financial crises in the future.'

- *Hypothesis 3 – The Wrong Medicine of the International Monetary Fund (IMF)*: By enforcing the abrupt shutdown of banks in difficulties, the tightening of central bank credit, and the reduction of budget deficits through cuts in government expenditure, the IMF's 'rescue' packages converted a minor downturn into a deep recession, and helped to exacerbate (if not initiate) the regional panic by constantly issuing dire diagnoses of the patient. This is why many Koreans have dubbed the perfect storm they found themselves in as 'The IMF Crisis.'

It is convenient to embrace Hypothesis 1 readily because no economy is without its flaws. However, the fact that output in Malaysia, Korea, and Thailand rebounded just as quickly as they had fallen falsifies the initial IMF belief that, besides monetary-fiscal tightening, drastic overhaul of the economic system and incentive structure similar to those undertaken earlier in the former Soviet bloc (e.g. immediate increase in the capital adequacy ratio and abrupt large-scale closure of financial institutions) were necessary to restart growth. This initial misjudgement explains why the IMF kept under-predicting until the end of 1998 the strength of the growth that occurred.

Now in light of the financial meltdown of the US financial markets in the last quarter of 2008 and the massive indiscriminate bailout of financial institutions that was conducted by the US Treasury and the US Federal Reserve, it is highly credible to believe that Hypothesis 2 (Financial Market Panic) was the root cause of the Asian financial crisis, and that Hypothesis 3 (IMF's incompetence) was an important contributor to the deepening of the crisis in

[1] See, for example, Woo, Schwab and Sachs (2000), and Blustein (2001).

Indonesia, Korea, and Thailand. The V-shape of East Asia's rebound (except for Indonesia, where the financial crisis sparked off a meltdown of its political system) rejected the view of Hypothesis 1 that structural adjustment was the precondition for economic recovery.

The many careful studies in the voluminous literature on the Asian financial crisis have produced valuable insights on every dimension of the crisis: the origins, early detection, pre-emptive interventions, emergency-room macroeconomics, and post-crisis recovery. On the topic of the types of economic policy cooperation that are appropriate for Asia, there are two lessons that are particularly useful. The first lesson concerns the natural working of the market mechanism, and the second concerns the availability of help during a financial crisis.

There has long been a tradition of resistance within the economics profession to acknowledge the phenomenon of disorderly market behaviour. The fact that financial contagion was common in the 1990's cannot be in serious dispute: the European Exchange Rate Mechanism crisis in 1992-93, the Mexican and Latin American financial crisis in 1994-95, the Asian financial crisis in 1997-98, the conversion of the Russian Ruble to a rubble in August 1998, and the collapse of the Brazilian Real in January 1999. It stretches credibility and imagination that all these governments had coincidentally shifted to destabilizing policies in the same decade. Herein lies the first lesson from the Asian financial crisis: occasional excessive price movements in financial markets are normal and should not be labelled in a knee-jerk fashion as the natural consequences of anticipated instability in future government policies.[2] In short, one should recognize the existence of occasional market failure and avoid the ideological position that all supposed market failures are actually government failures in origin.

The second important relevant lesson from the Asian financial crisis is that 'the only form of reliable help during an economic emergency is self-help'. The only country that was willing to commit immediate large-scale financial assistance to the crashing Asian economies was the neighbouring country of Japan, which proposed the Asian Monetary Fund (AMF). Japan did not succeed in establishing the AMF, however. Four of the key reasons for the failure of the AMF initiative were that:

- some important developed countries believed in the crony capitalism explanation of the crisis and concluded that the AMF would merely mean throwing more money to the undeserving, corrupt elite of these countries;
- some other developed countries wanted to protect the monopoly position of the IMF so that they could continue to command a disproportionate influence on world affairs;
- the PRC was not prepared to be rushed into supporting a new regional institution without careful consideration of its long-run implications; and
- some observers saw that most of the biggest creditor banks to ASEAN were Japanese banks and they felt that the Japanese enthusiasm for the AMF was based on the desire to minimise the financial losses of these Japanese banks.

Self-help is fundamentally important because the IMF could not be counted upon to be correct in its diagnosis of a balance of payments crisis. Moreover, the United States could not be expected to be ready to help out countries in desperate straits. In the three-decade long rule of General Soeharto, he had been bailed out several times before by the US and its allies (notably Australia,

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[2] The phenomenon of instability in exchange rate value being caused by expected future instability in macro-policies (rather than by forex market failure like 'destabilising speculation') is often called the 'peso problem.'

Japan, Holland, and the international financial institutions), and it was thus quite natural for him to expect some external aid when things started going awry in the last quarter of 1997. Soeharto was mistaken. He did not realise that with the end of the Cold War in 1992, he was dispensable to US security and ideological interests just as his fellow general, Joseph Mobuto of Congo-Leopoldville, was dispensable. Furthermore, a crisis in Indonesia was simply not as important to US policymakers as a crisis in Mexico because Indonesia is not an immediate geographical neighbour to the US and thence could not send a tsunami of unemployed workers into the US. Finally, as Soeharto approached the end of his natural life-span, the Americans (after their costly experience hanging on to the Shah of Iran until the bitter end in 1979) had become more interested in who would be replacing him than in maintaining him in power.

The above two lessons propelled the East Asian countries after their recovery to go on a reserves accumulation spree to insulate themselves from future speculative attacks (i.e. be independent of the supervision of the IMF). These lessons also led the Asian countries — the 10 ASEAN countries, the PRC, Japan, and Korea, collectively called ASEAN+3 — to start the process of currency and financial cooperation when they met in Chiang Mai, Thailand, in May 2000. The outcome of this ASEAN+3 meeting was the establishment of the Chiang Mai Initiative (CMI) mechanism to enable these countries to come to each other's aid if similar speculative attacks were to reoccur.

The CMI was a pooling of the foreign exchange reserves of ASEAN+3 through each country entering into a web of bilateral swap arrangements. The CMI was really an enlargement of the ASEAN Swap Arrangements (ASA) started in 1977 among the original 5 ASEAN members (Indonesia, Malaysia, Thailand, Philippines, Thailand). The size of ASA resources was US$200 million in 1997, and this amount was totally inadequate when the Asian Financial Crisis hit in 1997.

At the same May 2000 meeting in Chiangmai, the finance ministers of ASEAN+3 also launched the Economic Review and Policy Dialogue (ERPD). 'The ERPD is a regional economic surveillance process, designed to contribute to the prevention of financial crises through the early detection of irregularities and vulnerabilities and the swift implementation of remedial policy actions. Its modality is information exchange, policy discussions, and peer reviews, which are the basis for enhancing regional monetary and financial cooperation.' (West, 2014.)[3]

The CMI and EPRD marked the beginning of an accelerated process of comprehensive economic integration in East Asia. In November 2001, the PRC and ASEAN agreed to start negotiations for an ASEAN+1 free trade area (FTA) that would be achieved in 2010. By November 2002, the PRC and ASEAN had made enough progress to sign the framework agreement for the ASEAN+1 FTA. This fast pace of economic embrace between ASEAN and the PRC had the synergistic effect of accelerating what had been a leisurely-paced process of incremental economic integration within ASEAN, and energizing Japan into active FTA negotiations with ASEAN.

[3] West (2014) reported that the 'ERPD process has not been as successful as initially expected, though gradual improvements have been made over time. Indeed, according to one commentator (Menon), the current ERPD process is still largely a venue for information-sharing at best, and a beauty contest at worst, with weak peer review and surveillance.'

In 2002, the ASEAN+3 established the Asian Bond Market (ABM) to keep funds within the region. The assumption is that if there were an unjustified (i.e. panic-stricken) capital flight from one Asian country, the existence of the ABM would channel these funds to the other Asian countries. ABM is a defensive mechanism (just like the anti-ballistic missile), and it worked by reducing the probability of a collective capital flight from out of Asia.

The ambition of Asian economic integration, or at least its rhetoric, has continued to broaden. The annual ASEAN+3 conference in 2005 was supplemented by the East Asian Summit (effectively an ASEAN+6 conference) to include Australia, India and New Zealand. The host of the 2005 conference, Prime Minister Abdullah Badawi of Malaysia, expounded on an ambitious vision of the Asian community. ASEAN announced in 2007 that it would become an EU-style ASEAN Economic Community by 2015.

At the May 2006 meeting of the Asian Development Bank (ADB) in Hyderabad, India, the ADB led the call for the introduction of an Asian Currency Unit (ACU) to coordinate exchange rate movements within the region. This ACU proposal was similar to the first major step toward currency unification in Europe when the European Currency Unit (ECU), more popularly known as the European Currency Snake, was introduced in 1976 to coordinate a joint float against the US dollar. Would the Hyderabad proposal eventually grow into an Asian Monetary Union about twenty-five years later?

In April 2011, the ASEAN+3 Macroeconomic Research Office (AMRO) was established in Singapore. AMRO is set to be 'an independent regional surveillance unit to monitor and analyse regional economies and support Chiang Mai Initiative Multilateralization (CMIM) decision-making.'[4]

Given the many parallels between the fast Asian developments in the last decade with the movement in Europe from the Treaty of Rome in 1957 that established the European Economic Community to the Maastricht Treaty in 1993 that formalised the European Union (EU), the sense of history repeating itself is naturally a strong one. Is there an Asian Economic Union (AEU) in the offing? Would it come soon, just like a late industrializer normally taking off at an explosive speed compared to the first industrializer?

We know enough from painful experiences, however, to be wary of linear thinking, otherwise, there would never be any turning points in history. We do well to remember the famous words: 'history repeats itself, first as tragedy, second as farce'.[5] We will take up this issue in Section 5 of this paper.

4.3 ASEAN's government-driven integration under AEC 2015

The AEC represents a quantum leap towards deep integration. But it stops short of free flows of capital and unskilled labour, government procurement among others, reflecting continuing sensitivity on these issues for many ASEAN states. **Table 4** below shows the AEC 2015's pillars and core elements.

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[4] Quote is from AMRO website (http://www.amro-asia.org/), accessed on July 26, 2014. AMRO is still a very small organization.

[5] This is the common paraphrase of the opening sentences in Karl Marx (1852).

Table 4: AEC Blueprint 2015 - Four Pillars and Core Elements

Pillars	Core elements
A. Single market and production base	A1. Free flow of goods: 9 strategic approaches A2. Free flow of services: 3 strategic approaches A3. Free flow of investment: 5 strategic approaches A4. Freer flow of capital: 7 strategic approaches A5. Free flow of skilled labour A6. Priority integration sectors A7. Food, agriculture and forestry
B. Competitive economic region	B1. Competition policy B2. Consumer protection B3. Intellectual property rights B4. Infrastructure development: 10 strategic approaches B5. Taxation B6. E-commerce
C. Equitable economic development	C1. SME development C2. Initiative for ASEAN Integration
D. Integration into global economy	D1. Coherent approach toward external economic relations D2. Enhanced participation in global supply networks

Source: compiled from Secretariat (2008), 'ASEAN Economic Community Blueprint'.

Potential economic benefits of AEC

- *Trade in goods and services liberalization and facilitation:* These boost intra-ASEAN trade, with positive effects on growth and employment, resource allocative efficiency, increased economic competitiveness, lower consumer prices, and wider consumer choice. It facilitates integration into GVCs and GPNs. Behind-the-border measures such as competition policy and protection of intellectual property encourages technology transfer and local innovations.
- *Investment and skilled labour flows liberalization and facilitation:* Inflows of FDI bring financial resources, technological and managerial knowhow, and participation in GVCs and GPNs. Skilled labour mobility leads to effective implementation of services and FDI liberalization as well as improved regional allocation of scarce skill resources.
- *Narrowing the development gap*: CLMV as less developed and transitional economies face greater difficulties in implementing AEC agreements. Hence they were accorded 'special and differential treatment' with delayed time-lines and flexibilities in meeting ASEAN liberalization commitments, and provided with development and technical assistance for capacity building. Narrowing the development gap among ASEAN economies helps achieve regional market integration, community building, and social cohesion.

Summary evaluation of AEC progress[6]

ASEAN economic cooperation and integration have come a long way. The AEC has made

[6] This section draws heavily on Chia (2017).

substantive progress in implementing measures outlined in the AEC Blueprint and in subsequent initiatives such as ASEAN infrastructure connectivity.

The deadline of 31 December 2015 passed with the declaration of the AEC but no 'big bang' effect, as many measures and actions have been progressively implemented over the years and there was much unfinished business. 'Works-in-progress' extending beyond 2015 include: elimination of nontariff barriers (NTBs); trade facilitation measures including improvement of customs procedures, ASEAN Single Window, and e-commerce; investment liberalization and facilitation; and measures for harmonization of standards, protection of intellectual property, competition policy, SME development, capital market development, and transport and logistics development.

The AEC can be evaluated using the AEC implementation scorecard and the AEC objectives realization, as discussed below:

- *Scorecard*[7]: This tracks the implementation of measures and strategic schedules in the AEC Blueprint 2015. Its publication in 2012 covering the period 2008-2011 set alarm bells ringing that the 2015 deadlines would not be met. Two lists of Prioritised Key Deliverables (PKDs) were drawn up, for implementation by 2013 and 2015 respectively. In 2015, the unimplemented PKDs were reviewed and a further prioritization undertaken. By the end of October 2015, the implementation rate was 92.7 percent based on 506 prioritized measures, but only 79.5 percent based on the full 611 measures.
- *Progress towards the AEC's objectives*: These were contained in 3 documents released by the ASEAN Secretariat in November 2015.[8]
    - 'Implementation of AEC Blueprint 2015 has been substantively achieved in, among others, eliminating tariffs and facilitating trade; advancing the services trade liberalisation agenda; liberalising and facilitating investment; streamlining and harmonising capital market regulatory frameworks and platforms; facilitating skilled labour mobility; promoting the development of regional frameworks in competition policy; narrowing the development gap; and strengthening ASEAN's relationships with its external parties.' (ASEAN 2025: Forging Ahead Together p59)

Highlights of achieving AEC objectives and goals

- *Tariff elimination*: The most noticeable achievement has been tariff elimination. Tariff lines in the AFTA Inclusion List (IL) were eliminated by beginning of 2015 and other products in the Sensitive List, Highly Sensitive List, and General Exclusion List were gradually phased into the IL. CLMV were allowed flexibility up to 2018 on 7 percent of tariff lines for sensitive products.
- ATIGA (ASEAN Free Trade in Goods Agreement) came into force in 2010 to replace AFTA. By 2015, 96.0 percent of ATIGA tariff lines had achieved zero tariffs. This may be compared with ASEAN countries' MFN bound and applied tariffs as shown in Table 5 below.

[7] ASEAN Secretariat (March 2012).
[8] These are 'A Blueprint for Growth. ASEAN Economic Community 2015: Progress and Key Achievements; ASEAN Integration Report 2015'; and 'ASEAN 2025: Forging Ahead Together'.

Table 5: ASEAN countries MFN tariff profiles

Country	Binding Coverage	MFN bound simple average (%)			MFN applied simple average (%)		
		Total	Agricultural	Non-Agricultural	Total	Agricultural	Non-Agricultural
Brunei	95.3	25.4	32.1	24.4	1.2	0.1	1.3
Indonesia	96.3	37.1	47.1	35.6	6.9	7.6	6.7
Malaysia	84.3	22.3	62.1	14.9	6.1	9.4	5.5
Philippines	67.0	25.7	35.1	23.4	6.3	9.9	5.7
Singapore	69.6	9.6	23.3	6.5	0.2	1.1	0.0
Thailand	75.0	27.8	38.5	25.5	11.0	30.7	7.7
Cambodia	100.0	19.1	28.2	17.8	11.2	14.9	10.6
Laos	100.0	18.7	19.2	18.7	10.0	20.1	8.3
Myanmar	17.8	84.1	106.2	21.2	5.6	8.6	5.1
Vietnam	100.0	11.5	19.1	10.4	9.5	16.3	8.4

Source: WTO online country tariff profiles

- *Non-tariff barriers elimination and trade facilitation*: This remains problematic as many non-tariff-measures (NTMs) also serve other policy purposes. Compiling the NTM database and identifying those that are NTBs and undertaking the domestic regulatory reforms involve multi-agencies and prove time-consuming. Many trade facilitation measures are behind schedule and include customs integration, ASEAN Trade Repository (ATR), ASEAN Single Window (ASW), standards recognition and harmonization, technical regulations and conformity assessment procedures (STRACAP) and e-commerce
- *Services trade liberalization*: Implementation difficulties led to a flexible 'ASEAN minus X' approach, whereby only 2 ASEAN countries are needed to initiate negotiations on specific sectors/sub-sectors, with others joining later. The general reluctance to liberalize services under Mode 3 (commercial presence) and Mode 4 (movement of natural persons) led to progressive liberalization for Modes 3-4. Mode 3 liberalization has a maximum 70 per cent ASEAN equity share, while Mode 4 liberalization is confined to movement of professionals. Nine packages of commitments have been concluded under AFAS.
- *Free flow of investment and freer flow of capital:* The AIA was replaced by the ACIA (ASEAN Comprehensive Investment Agreement) in March 2012, with wider sectoral coverage, extension of national treatment to ASEAN-based foreign investors; a single negative list for scheduling reservations; and a new dispute settlement mechanism. However, ACIA remains cobbled by extensive national exclusion lists and limitations on foreign equity and land ownership. The Blueprint sets out to achieve a well-integrated and well-functioning regional financial system. The ASEAN Financial Integration Framework (AFIF) was adopted in 2011. There is much unfinished business.
- *Free flow of skilled labour:* Mutual recognition arrangements (MRAs) for professionals serve to facilitate free flow of skilled labour, taking into consideration relevant domestic regulations and market demand conditions. ASEAN countries maintain varying restrictions on the entry and employment of foreign professionals. MRAs have been concluded in 8 professions covering engineering services, nursing services,

architectural services, surveying qualifications, medical practitioners, dental practitioners, accounting services, and tourism professionals

- *Competition and intellectual property:* The challenge is how to minimise the anti-competitive behaviour of state-enterprises and discriminatory government procurement practices. Implementing intellectual property protection remains a challenge in several ASEAN states.
- *Infrastructure development:* The Master Plan on ASEAN Connectivity (MPAC) 2010-2015 outlining ASEAN connectivity on land, sea, and air remains a 'work in progress'.
- *Equitable economic development*: In the past decade, the CLMV have experienced more dynamic growth than the ASEAN6 and are participating in GPNs and undertaking economic restructuring and human resource development to attract investment inflows. However, absolute gaps between ASEAN's middle-income and least developed economies remain sizeable. The Strategic Action Plan for SME Development for 2010-2015 has key strategies to support SME access to finance, market and internationalisation, human resource development, information and advisory services, and technology and innovation. Some of these initiatives have been completed while some will continue beyond 2015. The Initiative for ASEAN Integration (IAI) Work Plan I was implemented through a collection of projects proposed by ASEAN states and were either self-funded or funded with support of donor partners. The IAI Work Plan II focuses on assisting CLMV meet specific ASEAN-wide targets and commitments and mostly comprised training and capacity building initiatives.
- *Integration into the global economy:* ASEAN has forged economic linkages with external partners through implementing FTAs/CEPs with China, Japan, South Korea, India, Australia, and New Zealand. To better realize their benefits would require better preference utilisation by ASEAN firms and improved supply capacity of ASEAN states, including adequate infrastructures and enabling regulatory regimes. Negotiations on the RCEP started in 2013 but progress has been slow and deadlines have been missed.

4.4 ASEAN's government-driven integration under AEC 2025

The AEC Blueprint 'ASEAN 2025: Forging Together Ahead' released in November 2015 builds on AEC 2015's 4 pillars with emphasis on integration areas that are still 'works- in-progress', and further responses to the rapid changes in technology and globalization and the demand for equitable, inclusive, sustainable, and innovative growth. The AEC 2025 Consolidated Strategic Action Plan (CSAP) was adopted in early 2017, laying out the 153 strategic measures and 525 specific action lines and expected timelines of implementation from 2016 to 2025, as well as sectoral work plans and bodies. The characteristics and core elements are summarized in **Table 6.**

The AEC 2025 remains a hybrid FTA-plus. There is no progression towards a Customs Union with a common external tariff (which would obviate the problematic need for certification of origin) and common commercial policy. Establishing an ASEAN CU would be politically and economically difficult as some ASEAN countries would have to set their common external tariffs above their MFN tariffs and be subject to WTO penalties for contravening GATT Article XXIV and GATS Article V. Further, many ASEAN countries would find it difficult to surrender sensitive sovereign policy space with a common external commercial policy. Also, there is no progression towards a EU-style Common Market with free movement of labour and capital and establishment of supra-national institutions. The AEC 2015 already faced tremendous difficulties in implementing skilled labour mobility and it would be politically challenging to allow for free flow of low-skilled and unskilled labour as well. Even in the EU and in the US, the issue of immigrant labour has led to Brexit and Trump's election promise to build a border wall with Mexico. Recent difficulties faced by the Eurozone also calls for caution in financial integration in ASEAN, given the diversity in financial market development, management, and prudential regulations among ASEAN states.

Table 6: AEC Blueprint 2025 – 5 Characteristics and Core Elements

Characteristics	Core elements
A. Highly integrated and cohesive economy	A1. Trade in goods A2. Trade in services A3. Investment environment A4. Financial integration, financial inclusion, and financial stability A5. Facilitating movement of skilled labour and business visitors A6. Enhance participation in global value chains
B. A competitive, innovative and dynamic ASEAN	B1. Competition policy B2. Consumer protection B3. Strengthening intellectual property rights cooperation B4. Productivity-driven growth, innovation, R&D, and technology commercialization B5. Taxation cooperation B6. Good governance B7. Effective, efficient, coherent, and responsive regulations and good regulatory practice B8. Sustainable economic development B9. Global megatrends and emerging trade related issues
C. An enhanced connectivity and sectoral cooperation	C1. Transport C2. Information and communication technology C3. E-commerce C4. Energy C5. Food, agriculture and forestry C6. Tourism C7. Healthcare C8. Minerals C9. Science and technology
D. Resilient, inclusive, and people-oriented, people-centred ASEAN	D1. Strengthening role of MSMEs D2. Strengthening role of private sector D3. Public-private partnership D4. Narrowing the development gap D5. Contribution of stakeholders on regional integration efforts
E. Global ASEAN	E1. Global ASEAN

Source: compiled from ASEAN Secretariat (2017), 'AEC 2025 Consolidated Strategic Action Plan'.

4.5. Extension of formal integration from ASEAN to ASEAN+1 and RCEP

The development of FTA networks with ASEAN's Dialogue Partners has been an integral part of AEC 2015, resulting in ASEAN-China (ACFTA) ASEAN-Japan (AJCEP), ASEAN-Korea (AKFTA), ASEAN-India (AIFTA) and ASEAN-CER (AANZFTA). These ASEAN+1 FTAs follow the pattern of FTA partner countries' FTAs (from weak and defensive for Japan and India to stronger for Korea and CER) as well as ASEAN's AFTA and AEC. They fail to seriously liberalise or provide much harder WTO plus disciplines on non-tariff and regulatory issues such as services, investment, MRAs and SPS (sanitary and phytosanitary standards) and does not cover government procurement. It is generally recognized that the AANZFTA is the strongest and the AIFTA is the weakest among them. The weak features of these FTAs reflect the region's political and economic diversity.

The Regional Comprehensive Economic Partnership (RCEP) comprises the ASEAN-10 as well as the 6 ASEAN+1 FTA partners. A mega-RCEP is preferable to the existing numerous and overlapping plurilateral and bilateral FTAs in ASEAN and the wider East Asian region. First, an integrated East Asia would increase mutual trust and understanding and awareness of common destiny (notwithstanding the recent rise in regional territorial conflicts). Second, a mega grouping confers larger economic benefits from economies of scale and scope, and more trade-creating and less trade-diverting effects. Third, it would further the development and spread of GVCs and GPNs; enables cumulative value added from a larger group of countries thus easing the rule of origin requirements; reduces the negative 'noodle bowl' effect from multiple and heterogeneous FTAs[9]; and promotes FDI and technology flows.

In November 2012, the launching of the 'Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership' was launched. The initial deadline of completing negotiations by 2015 has long since passed. The third RCEP Intersessional Ministerial Meeting on 21-22 May 2017 took stock of RCEP negotiations. While there is a need to address different levels of development and economic openness among RCEP negotiating members and produce a balanced document, there is also concern that the 'lowest common denominator' might prevail.

5. The Future Financial Architecture of ASEAN

5.1 Que Sera Sera – The Future's Not Ours to See?[10]

There have been many visions about the future of the financial architecture of ASEAN. One proposal that was popular in the period after the Asian Financial Crisis was an Asian Economic Union (AEU), where there was comprehensive, deep regional economic integration.[11] In 2004, Tadao Chino (2004), the then-President of the Asian Development Bank (ADB) asked Asia to consider the idea of a single Asian currency seriously:

[9] In addition to the six ASEAN+1 FTAs, several ASEAN countries also have bilateral FTAs with these six trading partners. Additionally, several ASEAN countries have bilateral agreements with a host of other trading partners in North and South America, Europe, Africa, the Middle East and South India.

[10] https://www.youtube.com/watch?v=xZbKHDPPrrc and http://www.metrolyrics.com/que-sera-sera-lyrics-doris-day.html.

[11] For example, Callick (2004) and Teo (2006).

> 'Renewed economic strength and robust intra-regional trade open a window for East Asia to move rapidly on the next steps towards potential monetary integration. It will be a long road. But the potential benefits in terms of smoother trade and investment, lower cross-border transaction costs, and stable exchange rates make it incumbent on the region to start seriously considering the possibility of a single currency and the transitional measures required to achieve it...'
>
> 'Europe's experience shows that creating a regional currency is a massive and slow job. However, East Asia has the advantage of learning from Europe and shortening the process of monetary integration. East Asia's economic dynamism will further help accelerate the process.'[12]

In 2004, Haruhiko Kuroda, then Special Advisor to the Japanese Cabinet, also opined that:

> 'The more we think about a single currency the greater the political factor seems to dominate. Especially in Asia, where political systems vary so much from country to country and political rivalries between countries are still so intense, we tend to be pessimistic about a single currency even in the long run.…[H]owever, if we look at the younger generations who are free from old nationalistic sentiment, we can be more optimistic.'[13]

After Haruhiko Kuroda succeeded Chino as President of ADB in 2005, he called for Asia to move 'towards a borderless Asia'. Then, in 2008, he reported that despite Asian economic integration being a challenging task, 'Asia is poised to take these steps'.[14]

Now in 2017, when China has emerged to be the largest economy in the world, and is expected to continue to grow dynamically, it has become fashionable to talk about the Renminbi (RMB) becoming the de facto currency of Southeast Asia. Just as there has been dollarization of some Latin American countries, there would also be a process of RMB-isation of the ASEAN members.

In short, would the future financial architecture of ASEAN either be a common AEU currency that also encompasses Northeast Asia or the use of the RMB as the common ASEAN currency?

5.2 The Economic Basis for Exchange Rate Coordination and a Common Currency

The basic question is whether the final realized form of the Asian Economic Union (AEU) would be closer to the European Union (EU) or to the North America Free Trade Area (NAFTA). So far, no prominent proponent of AEU has advocated a future political union as the final objective. While political objectives like avoidance of armed conflict among traditional competitors might suffice to drive the economic integration agenda, it would be more rational to also explicitly acknowledge the economic costs of these political decisions.

[12] Chino (2014).
[13] Reported in 'The Case for Asian Monetary Union', Wall Street Journal, June 1, 2004.
[14] Kuroda (2005) and Kuroda (2008).

To put the issue more fundamentally, is there a case for exchange rate coordination (and maybe, monetary integration) within AEU in the absence of political unification?

In our opinion, we cannot compare the relative merits of an EU-type AEU and an NAFTA-type AEU without stating what the world would look like in the future. Conveniently for us, comprehensive predictions of the state of the world in 2030 and 2050 are contained in in a PricewaterhouseCoopers (PwC) study completed in 2013.[15] **Table 7** reports the PwC (2013) projections of the GDP (measured at market exchange rates) in 2011, 2030 and 2050 of the major countries in NAFTA, EU and AEU in 2011 USD.

Table 7: Projections of GDP in 2030 and 2050				
	(in billions of 2011 USD)			
Part A:	US	Canada	Mexico	Brazil
2011	15,094	1,736	1,155	2,477
2030	23,376	2,424	2,830	4,883
2050	37,998	3,549	6,706	8,950
Part B:	Germany	France	UK	Italy
2011	3,571	2,773	2,432	2,195
2030	4,374	3,805	3,614	2,791
2050	5,822	5,714	5,598	3,867
Part C:	China	Japan	Korea	Indonesia
2011	7,298	5,867	1,116	847
2030	24,356	6,817	2,078	2,465
2050	48,477	8,065	3,315	5,947
Source: Appendix B in Price, Waterhouse, Cooper (2013)				

Part A of Table 7 focuses on four countries in the Americas (USA, Canada, Mexico, and Brazil), Part B focuses on four countries in Western Europe (Germany, France, United Kingdom, and Italy), and Part C focuses on four potential members of the proposed Asian Economic Union (China, Japan, South Korea, and Indonesia). Making projections about future GDP is of course an exercise that involves bold assumptions about many uncertainties. This is especially true for Asia where fast economic growth and large-scale structural transformation are occurring. It is therefore reassuring that two other projections about the future — the 2005 Goldman-Sachs projections and the 2007 Goldman-Sachs projections[16] — show the same qualitative results as the 2013 PwC projections, e.g. the US is the economic giant in NAFTA now and will be the economic giant in NAFTA in 2050; and China will be the economic giant in East Asia in 2050.

Table 8 computes the relative size of each country in each year by calculating the ratio of its GDP to the total GDP of the group in that year. Part A of Table 8 reports that USA will account for 69.8% of the group GDP in 2030, and 66.4% in 2050, down from 73.8% in 2011.

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[15] The PwC (2013) report was written by John Hawksworth and Danny Chan.

[16] The 2005 and 2007 studies by Goldman-Sachs are O'Neill, Wilson, Purushothaman and Stupnytska (2005); and Dominic Wilson and Anna Stupnytska (2007).

Table 8: Relative Size of Countries in 2030 and 2050				
	(in % of row total of GDP in each year)			
Part A:	US	Canada	Mexico	Brazil
2011	73.8	8.5	5.6	12.1
2030	69.8	7.2	8.4	14.6
2050	66.4	6.2	11.7	15.6
Part B:	Germany	France	UK	Italy
2011	32.5	25.3	22.2	20.0
2030	30.0	26.1	24.8	19.1
2050	27.7	27.2	26.7	18.4
Part C:	China	Japan	Korea	Indonesia
2011	48.2	38.8	7.4	5.6
2030	68.2	19.1	5.8	6.9
2050	73.7	12.3	5.0	9.0
Source: Computed from Table 7				

While the United States would become increasingly large vis-a-vis Canada and decreasingly large vis-a-vis Mexico and Brazil, the fact is that the US is the overwhelmingly dominant country in the Americas at the present and will continue to be overwhelmingly dominant in the future. In 2050, the US will still be almost ten larger than Canada and almost four to five times larger than Mexico and Brazil. Given this great disparity in economic size, it will always be true that independent economic shocks in Canada and Mexico would have very limited impact on the US economy, while a sneeze by the US could send powerful tremors to the other two NAFTA members. In such an unequal situation, the survival of individual currencies is natural because the giant US economy sees no advantage in allowing its monetary policy to be influenced by the concerns of the smaller economies, and Canada and Mexico could use the exchange rate as an additional instrument to help offset shocks (especially trade shocks) originating from the US economy.

Part B of Table 8 reports that the relative size of the four largest economies in Western Europe (Germany, France, United Kingdom, and Italy) will remain qualitatively similar across time, with no one country being dominant in the country. Germany's share of total GDP would decline from about one-third in 2011 to one-quarter in 2015, France's share will stay at about one-quarter of total over the 201-2025 period, the UK will move from one-fifth of total GDP in 2011 to one-quarter of total in 2050, and Italy will stay at one-fifth of total GDP in the entire time span.

The GDP ratios reveal clearly that the biggest EU economies are of about the same magnitude now and will continue to be so in the future. This means that independent shocks in each country will have sizable spillover effects on the others. This high level of economic interdependence amongst EU members means that the welfare of each member would be increased if national economic policies were coordinated in a manner that reduces negative spillover effects. One instrument for achieving this welfare-enhancing cooperative solution is a common currency.

Part C of Tables 7 and 8 show that the distribution GDP of four major East Asian economies (China, Japan, Korea, and Indonesia) will display drastic changes over time. China's size of total group GDP will rise from 48.2% in 2011 to 68.2% in 2030 and then to 73.7% in 2050; while Japan's share from 38.8% in 2011 to 19.1% in 2030 and then 12.3% in 2050. Korea's share will also decline over time from 7.4% in 2011 to 5.0% in 2050; and Indonesia's share will rise from 5.6% to 9.0% in the same period.

Unlike the EU, AEU will not be a club of equals for any significant length of time. And, unlike NAFTA, there is no stable dominant economic giant across time. Japan was the undisputed economic giant in 2005; but the PRC will be the undisputed economic giant in 2050. If there was a compelling economic argument to form a Yen-bloc in 2005, then the same compelling economic reasoning would dictate that this Yen-bloc transform itself into a Yuan-bloc by about 2035.

The return of China as a major global economic power means that the Renminbi (RMB) could, in the future, attain an international status that is parallel to the USD.[17] The emergence of the RMB as a key international currency, however, does not in any way imply that it would also emerge to be the common currency for East Asia. It is unrealistic to expect that China would not have the same attitude in the future as the United States has at the present toward other countries that have dollarized their economies. Official US attitude is well summed up by the following remarks made by US Treasury Secretary Robert Rubin in 1999:

> '... it would not, in our judgment, be appropriate for United States authorities to extend the net of bank supervision, to provide access to the Federal Reserve discount window, or to adjust bank supervisory responsibilities or the procedures or orientation of U.S. monetary policy in light of another country's decision to dollarize its monetary system.' (Rubin, 1999)

This type of individualistic attitude on the part of the large economies is exactly what is fostered by the asymmetrical spillover in a regional grouping dominated by a giant country. The large country does not see an economic case for surrendering its monetary independence.

It is also undesirable on another economic consideration for East Asia to adopt a common currency. This is the absence of serious consideration of complete integration of national labour markets in the official and academic discussions on an Asian Economic Union. If economy A is entering into inflation while economy B is entering into recession, economy A will want to raise the interest rate while B will want to lower the interest rate. The uncomfortable reality is that whatever the compromise interest rate policy might be, it would be optimum only if labour from B could move freely and costlessly into A.[18] Without unhindered labour mobility across A and B as the adjustment mechanism to a common monetary policy, the benefits of a common currency could be greatly reduced, if not, overwhelmed.

Our final assessment is that, one, the NAFTA-like disparity in economic power in AEU in the future, and, two, the absence of policy-induced integration of national labour markets mean that the only stable configuration is the survival of individual East Asian currencies with

[17] Woo (2014) and Woo, Pan, Sachs, and Qian (2014).

[18] This is the fundamental insight of Mundell (1961).

limited coordination among them in normal times. It therefore appears to us that the many present efforts to promote closer exchange rate cooperation will not succeed in the long-run.

6. Looking Forward: Some Final Remarks

On the financial side of ASEAN economic integration, we support the formal merger of CMIM and AMRO to create the Asian Monetary Fund (AMF). AMF will calm panic in the foreign exchange markets and assist countries in balance of payments adjustment, i.e. to attenuate the cost of bad luck and to minimize the cost of bad policies. Given the large size of East Asian foreign reserves, the AMF should take on the additional task of designing a pooling scheme where part of the East Asian reserves could be safely used to finance sound infrastructure projects in the poorest Asian countries. This outcome would be superior to the present practice of putting almost all of the East Asian foreign reserves into the assets of G-7 economies.

It is important that the AMF does not suffer from the institutional inertia that is characteristic of the present global organizations like the United Nations, the World Bank, and the International Monetary Fund. The leadership structure of the AMF should be designed to avoid simply locking in the balance of economic power that existed at the time of its founding; much like the unchanging composition of the permanent members of the UN Security Council, the head of the World Bank always being a US appointee and the head of the IMF always being a European. If AMF could adopt a self-updating type of leadership structure, its first contribution to the world (as well as to the East Asian region) would be the provision of an example to inspire positive developments in the reform of the leadership structure in the global organizations.

Overall, ASEAN has been successful in enabling a diverse and divided Southeast Asia gain a regional identity, fighting communist insurgency, and moderating interstate territorial conflicts to achieve overall regional peace and security. However, in going forward, ASEAN is again faced with geopolitical challenges of fighting Islamic terrorism, moderating interstate territorial conflicts particularly in the South China Sea, and containing big power rivalry, particularly between the US and China. The scale and nature of these challenges are seriously challenging ASEAN unity.

Will the rise of anti-globalization, anti-regionalism, and anti-immigration sentiments that afflict North America and Europe be echoed in the ASEAN region? While hitherto ASEAN integration initiatives have been largely top-down, going forward, there is a need for efforts to more openly embrace other stakeholders. The message of market economic liberalization needs to be marketed more effectively, seeking consultations and dialogues with the ASEAN private sector and workers to identify the losers in the economic integration project and provide mechanisms to 'compensate' them through financial and technical assistance programmes to enable firms to seek new businesses and workers to find new jobs through job training and retraining.

What is the future of ASEAN participation in the regional GVCs and GPNs? East Asia has benefited since the 1960s from the 'flying geese' pattern of regional development through

GVCs and GPNs, accompanying trade and investment liberalization and facilitation, and infrastructure and logistics developments. Japan was the 'lead goose', and as it moved up the value chain, there was industrial relocation into the neighbouring newly industrializing economies of South Korea, Taiwan, Hong Kong, and Singapore, and eventually into China and the rest of Southeast Asia. South Asia remained largely outside this orbit due to highly protectionist policies and poor logistics and infrastructure. China emerged as the hub of 'Factory Asia'. As coastal China moved up the value chain, there is a westward-interior migration of low-level industrial segments and minor spillovers into the ASEAN CLMV states and some South Asian states. More significantly, China's factories are rapidly adopting automation and robotics to overcome rapidly rising wage levels. This threatens to disrupt the hitherto cross-border transition of manufacturing activities in East Asia. China's Belt-Road-Initiative (BRI) is also rapidly transforming the infrastructure landscape of Asia and Europe and disrupting the geographical-transportation advantages of many locations.

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