Asian Journal of Business and Management (ISSN: 2321 - 2802)
Volume 02 – Issue 01, February 2014

A Brief Review of the ASEAN Economic Community's Progress

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ABSTRACT— ***A brief review of the ASEAN Economic Community's progress, expectations, and the possibilities they entail. As the integration process has received relatively little notice either in academic or in commercial publications, this review attempts to fill that gap by taking a brief look at the integration project that can only be described as substantial. To do this, the paper reviews some key economic figures, the roadmap of the integration, and some of the infrastructure projects related to the integration. Furthermore, it provides some pointers for investors.***

Keywords— ASEAN Economic Community (AEC), integration, roadmap, infrastructure projects

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1. INTRODUCTION

In October 2003 Association of Southeast Asian Nations (ASEAN) leaders declared an ambitious goal of creating the ASEAN Economic Community (AEC) and on 20th November 2007 the regional leaders adopted the ASEAN Economic Blueprint at the 13th ASEAN Summit to serve as a coherent master plan guiding the establishment of the AEC by the year 2015 [1]. The motives for the ASEAN economic integration might lay in the 1997-1998 financial crises and the role the IMF played in assisting the crisis-struck Asian nations [2,3]. Another motive to launch AEC stems from the desire to transform the region into an investment site and a production base for the world market in a competition with China [4]. Additional factor to be consider is how the AEC blueprint reviews security most notably energy security [1]. Regardless of the motives it is safe to say that the AEC will change the regional and global markets. The integrating community will cover over 605 million people of rapidly growing economies. The AEC aims high and it is the most sophisticated initiative of its kind, after the European Single Market, and on this scale it is the only one in the developing world [5]. When the size, complexity and the consequences are considered it is obvious that the AEC has received too little attention in the academic and public sphere.

The ASEAN single market and production base comprises five core elements:

1. free flow of goods
2. free flow of services
3. free flow of investment
4. free flow of capital
5. free flow of skilled labor.

In addition, the single market and production base also includes two important components, namely, the priority integration, as well as the food, agriculture and forestry sectors [1].

The Association's 10 members are very different in their composition in terms of population, per capita income, economic structure and resources. The ASEAN members Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam have all had strong economic growth for quite some time. National differences in terms of population, GDP, 2012 GDP growth in percentages, inward and outward foreign direct investment stock (FDI) are depicted in figure 1. During the past two decades the region has started to shift from the production of natural resource-intensive goods to electronics and other fairly sophisticated manufacturing [5]. The top ten ASEAN trade commodity groups of 2011 are detailed in figure 2. From figure 2 it can be observed that the top trade groups are manufacturing oriented except for the first group listed - mineral oils etc. What are especially noteworthy are the 2nd, 3rd and 4th groups in the list:

electrical machinery, nuclear reactors, boilers, and plastics respectively. The ASEAN countries' development strategy for the past several decades has been export oriented, which has led to a large tradable sector where the ratio in 2009 of total trade to GDP reached 103.6% [6]. Despite having a high degree of openness the member states do not trade with themselves as much as with other parts of the world. Intra-regional trade is about 24.5% of the ASEAN countries' total trade [6]. This can be compared to EU15 where the intra-regional trade is 49% [6].

Figure 1: Population, GDP, GDP growth and FDI

2012	Population	GDP	GDP growth	FDI
ECONOMY	million	Billion $	Percent	Million $
Brunei	0.42	16.85	1.3	850
Cambodia	14.48	14.25	6.5	1,557
Indonesia	244.77	894.85	6.2	19,853
Lao PDR	6.37	9.27	8.3	294
Malaysia	29.32	307.18	5.6	10,074
Myanmar	48.72	54.05	6.3	2,243
Philippines	96.47	240.66	6.6	2,797
Singapore	5.26	267.94	1.3	56,651
Thailand	69.89	376.99	6.4	8,607
Vietnam	89.73	137.68	5.0	8,368
ASEAN	**605.43**	**2,319.72**	**5.7**	**111,294**

Source: [7] IMF WEO (2012), [8] IMF REO (2013), [9] UNCTAD (2012)

Singapore and Malaysia have generally been the primary FDI recipients in ASEAN [10]. In contrast, the new members of ASEAN, such as Laos and Cambodia, have recently emerged as new attractive locations for FDI, while with Indonesia there has been some uncertainty because the inflows have not been steady, especially after the 1997 economic crisis [10]. One of the fascinating things about Myanmar is that since the 2010 election year there has already been an approximately 75 percent increase in the country's FDI in a matter of only two years [9]. The combined GDP of the region is a respectable 2.3 trillion US dollars. The GDP growth for the entire ASEAN region was around 5.7 percent for the year 2012 and is expected to grow for two consecutive years at around 5.5 percent per year [8].

Figure 2: The top ten ASEAN trade commodity groups of 2011

Commodity group1/	Value US $	million	
Description	Exports	Imports	Total trade
Mineral fuels, mineral oils & products of their distillation; bitumen substances; mineral wax	228,086.3	251,335.2	401,530.4
Electric machinery, equipment and parts; sound equipment; television equipment	249,590.6	221,941.0	273,577.5
Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	134,458.9	145,786.4	261,453.4
Plastics and articles thereof	37,323.1	35,136.8	65,626.1
Vehicles, (not railway, tramway, rolling stock); parts and accessories	31,336.9	34,339.3	57,561.8
Rubber and articles thereof	52,563.5	12,735.3	53,638.2

Organic chemicals	36,747.3	25,749.9	45,748.1
Natural or cultured pearls, precious or semiprecious stones, precious metals and metals clad therewith and articles thereof; imitation jewelry; coin	25,736.3	33,728.3	41,802.3
Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes	47,256.3	7,211.8	40,376.7
Iron and Steel	9,382.0	40,224.7	38,817.1
Top Ten Commodities	***852,481.4***	***808,188.8***	***1,280,131.6***
Others2/	***389,805.0***	***338,117.1***	***1,108,460.7***
Total	***1,242,286.4***	***1,146,305.9***	***2,388,592.3***

Source: [11] ASEAN secretariat (2012)

"The goals of the AEC are to achieve higher levels of economic dynamism, sustained prosperity, inclusive growth and integrated development of ASEAN" [1]. Several interested parties are watching how closely to the blue print will the integration process unfold and whether the process will have the desired effects. Deutsche Bank Research (2013) expressed some skepticism about the smoothness of the transition, but in general reviewed positively the integration's effect such as increasing trade, investment, and GDP [12]. The expected beneficiaries are the multinational corporations (MNC) due to cost savings because of less bureaucratic red tape, increased efficiency because of advantages of the regional networks, and productivity gains [12]. The winners are most likely companies with a regional presence, educated workers and the financial sector [12]. The negative impacts include the unskilled workers in higher wage countries, fiercer competition leading to tighter margins and economic bubble risks due to sudden rises in capital [12].

The AEC integration progress has so far fulfilled many of the expectations laid upon it. The 13th of January 2007commitment was reaffirmed in November 2007 and has been given further sanction through the ASEAN Comprehensive Investment Agreement (ACIA) which came into effect on 29 March 2012 to support a free, open, transparent and integrated investment regime in the ASEAN region [13]. This is in line with the goal to establish the AEC by 2015 [13]. Cambodia, Laos, Myanmar, and Vietnam (CLMV) already have provisions to phase out tariffs for the sensitive list products, the last of which should be done by 2017 for Cambodia [1]. The ASEAN Economic Ministers (AEM) have considered the future needs for a healthy investment environment and therefore extended protection to investors outside of ASEAN. These investors can now become ASEAN investors by creating juridical entities in any of the member states, and from there they can make investments as Judicial Persons in other member states [13].

2. PROSPECTS AND RECOMMENDATIONS

Previous research has thrown some light on the prospects and recommendations regarding the economic development of the ASEAN. The applicability of the lessons learned in Europe should be considered. Some of the recommendations have only been superficially established. Nevertheless, some researchers do provide significant recommendations on how to evaluate the progress achieved so far and how to proceed further.

Suh and Khan (2003), for example, endorse several measures for the ASEAN. Firstly the legal and regulatory environment should be conducive to the development and promotion of private enterprise and should therefore promote contract law, enterprise law, and property rights (including intellectual property)[14]. Secondly, the regional economic integration provides an opportunity for within-group firms to increase local operations and utilize the immediately accessible markets [14]. Thirdly, if ASEAN/AFTA countries encourage the development of manufacturing policies, this can provide a competitive advantage for them over the Central European Free Trade Agreement (CEFTA) or Latin American Integration Association (LAIA) [14]. Fourthly, good infrastructure promotes productivity which is an important component for increasing exports [14]. Fifthly, for the export oriented FDI for whom labor costs are a key factor, foreign firms are able to take advantage of a cheap labor pool in order to establish production facilities [14].

Dimensions of distance also affect differently exports and the FDI: as distance increases so do transport cost; total foreign sales fall with geographical distance but it is more costly for exports than the FDI [15]. For the FDI, "soft" barriers (language, culture and institutions), seem to be very important [15]. The explanation lies in the fact that local presence requires deep levels of involvement and experience in the local cultures and institutions. Furthermore, the need for knowledge of the local language is greater when operating a plant in a foreign market than when the goods are exported [15].

Mateev (2009) found when studying trade and manufacturing in central and southeastern Europe that the gravity factors (distance, population, and GDP) and non-gravity, or transition specific, factors (risk, labor costs, and corruption) can explain, to a large extent, the amount of FDI flows into transition economies [16]. Also of note for the CLMV countries are Maatev's (2009) findings that the FDI flows to the transition countries were determined by the same macroeconomic and transition specific factors as for the other countries and not by the timing of their integration [16]. The lesson from the European integration would suggest that the single market that is created generates gains through comparative advantage and develops new horizontal trade opportunities that are based on economies of scale [5].

The claims that the AEC creates opportunities on several fronts and reforms, which would have otherwise been out of reach had the countries acted alone [17], are certainly credible. Petri, et al., using a computable general equilibrium (CGE) model, arrived at estimates that suggest significant benefits from the AEC [5]. Provided the foundations are solid, the integration will provide for long-term development, and if ASEAN members will implement the promised agreements, the region's accelerated growth could even pick up some of the slack left by the slowly growing Europe and USA [5]. Moreover, due to investment diversion effects most economies not part of ASEAN would experience losses because of the AEC [5]. The losses would be felt in Europe, China and Korea, with the exception being Australia, where the losses are rather small and the overall net gains are higher than the losses [5]. The losses to the outside trading partners occur because of the increased intra-regional trade [5].

ASEAN member states have made great developmental strides during the past two decades by improving the efficiency and reliability of their financial institutions, money and capital markets. Nevertheless, the asset sizes are not large enough to compete effectively with global players, because the banks and other financial institutions are small, segmented, and illiquid, making them vulnerable to outside shock. Therefore, financial integration should be given high priority [6]. Masron (2013), on the other hand, encourages the region to develop effective national strategies for local entrepreneurs so that national firms could eventually emerge as regional players and thus provide internal stability [10].

3. THE PATH TO THE PRESENT AND THE FUTURE

The planned integration provides stability, certainty and transparency in the region's business environment [17]. Masron (2013) found that majority of ASEAN MNCs FDI inflows are either resource-seeking or efficiency-seeking, thus creating vulnerability if a member state loses competitiveness in one or both of them [10]. In many regards Masron's fear seems currently unfounded, as the ASEAN region seems much more competitive at least when comparing labor costs (see figure 3). Another factor that attracts MNC in the region is the increased mobility of goods, increasingly so as the transitional economies become fully integrated.

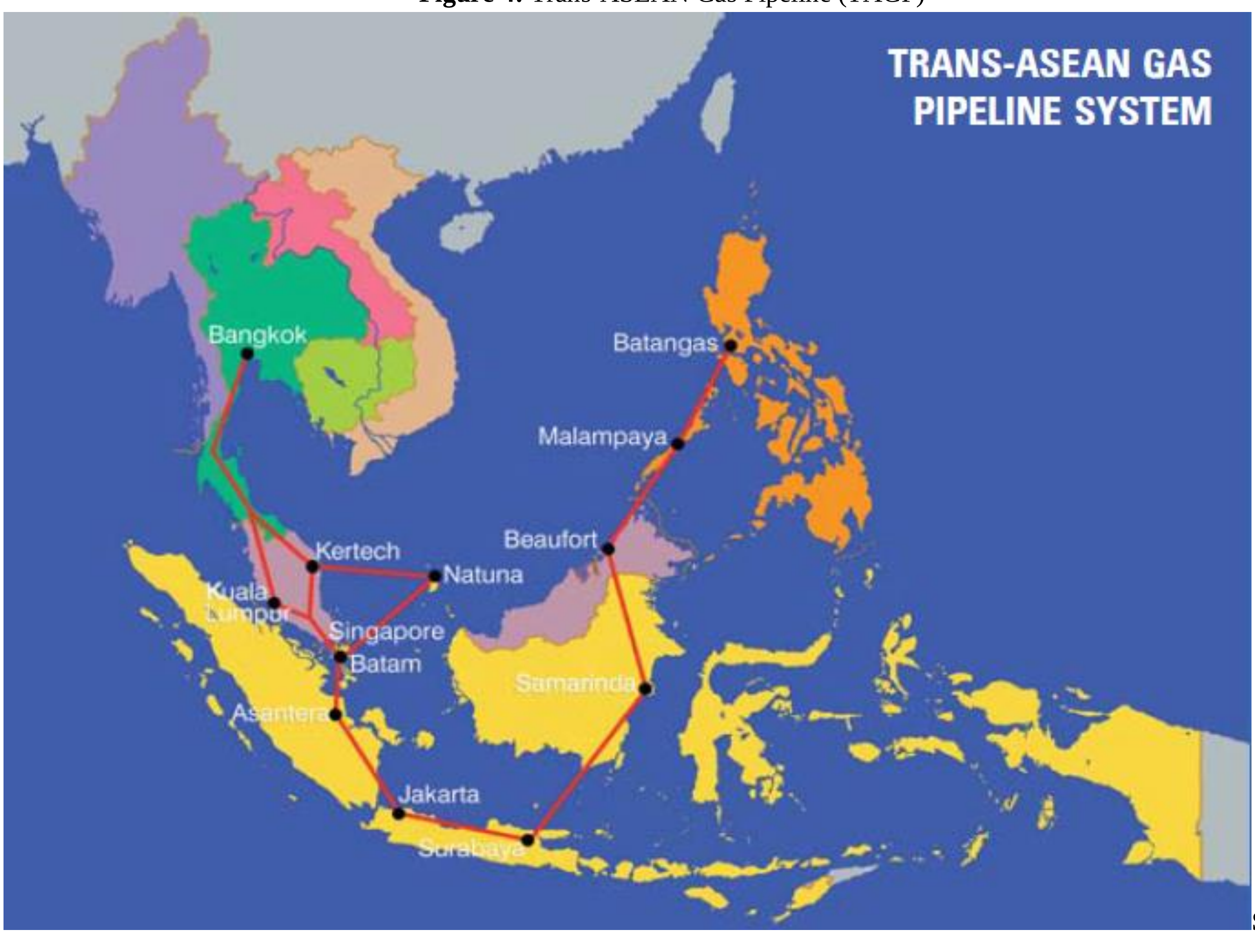
Figure 3: The daily minimum wage range in US dollars depending on location and profession

Minimum wage	Daily US $
Myanmar	1.25*
Cambodia	2.03
Vietnam	2.22-3.17
Indonesia/Jakarta	2.95-5.38
Thailand/Bangkok	6.99-9.45
Philippines	6.06-10.60
China/Shanghai	4.00-7.90
Taiwan	19.8
Hongkong	28.87
South Korea	31.8
Japan	65.78-85.36
Australia	130.06

Source: [18] NWPC (2012), [19]*Xinhuanet.com

In the AEC blue print, apart from aspirations towards higher transparency and policies aiming at good business practices, it is infrastructure projects that deserve consideration.

Figure 4: Trans-ASEAN Gas Pipeline (TAGP)

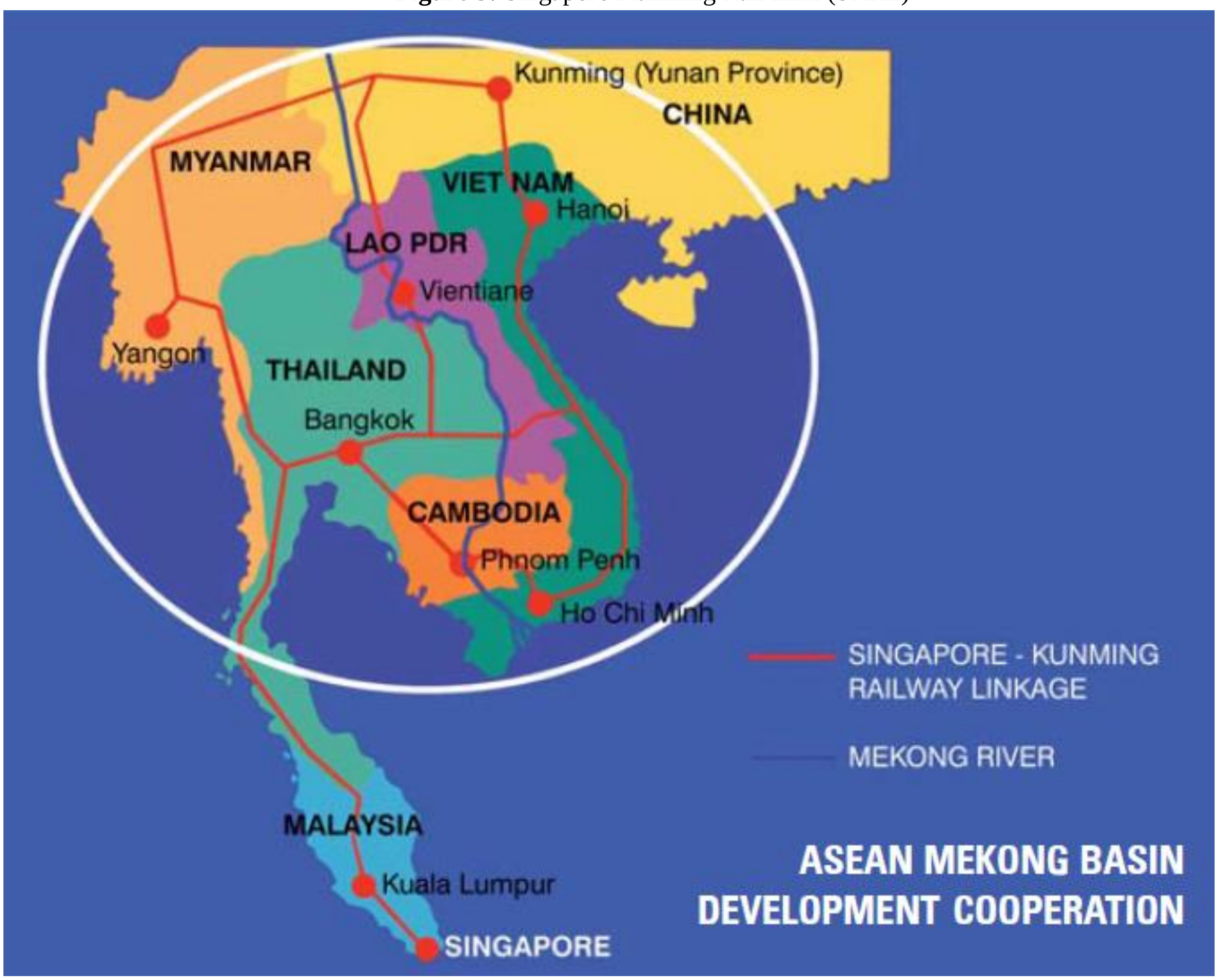


Source: [20] ASEAN investment map (2009)

The energy cooperation that is for a significant component of the AEC blue print, makes clear the need to have a secure and reliable supply of energy. This includes bio-fuel which is separately highlighted and is considered to be of crucial support to economic and industrial activities [1]. Another project to support energy reliability is the Trans-ASEAN Gas Pipeline (TAGP), created in collaboration with the region, the extent of which can be seen in figure 4. Thirdly there are ASEAN Power Grid Projects, all of which should optimize the region's energy resources that are intended to provide greater security as well as private sector opportunities for investment, finance, and technology transfer [1].

Also worthy of mention is the Maritime Transport Roadmap to integrate the ASEAN shipping market in order to strengthen functional internal markets and The Open Sky Policy which is the aviation integration policy plan [1]. The plans also involves information infrastructure to create regional structure and increase security for electronic transactions, payments and settlements [1].

Figure 5: Singapore-Kunming Rail Link (SKRL)



Source: [20] ASEAN investment map (2009)

There are a number of experts who believe that the TAGP project, in its entirety, and if it includes the manufacturing areas of Northeast Asia, could have a $100 billion price tag, thus making it the most sizeable energy project in the region and one of the most capital hungry projects in the world [21,22]. Thailand is a strongly invested stake holder in the TAGP because of its central "middle man" position. Furthermore, the project provides increased energy security, anticipated spillover effects and construction work [22]. Myanmar is another heavily invested party, having possibly as much as 51 trillion cubic feet of natural gas offshore, among the largest reserves in all of Asia needing to connect with buyers [22]. Indonesia and Malaysia have their own political and economic reasons to promote TAGP, but it remains to be seen whether all of the stakeholders will be able to maintain aligned goals, as the stakeholders are quite diverse: Exxon-Mobile, the financial institutions, the Asia Development Bank, the Japan Bank for International Cooperation and the ASEAN member states [22].

In 2010 there were 4,069 kilometers of missing railway links or links that needed some repair or development in six countries, including Cambodia, Lao PDR, Malaysia, Myanmar, Thailand and Vietnam [23]. Besides the SKRL there is the ASEAN Highway Network (AHN) whose primary function is to support the movement of goods and connectivity [23]. These projects are implemented in order to achieve reductions in transport costs, the creation of new regional links and expansion of regional markets [23]. The transportation infrastructure projects provide a strong basis for the anticipated increases in manufacturing. Petri's, et al. (2012) study concluded that manufacturing is a beneficiary of the AEC because of higher productivity which in turn will affect intraregional trade and resource allocation [5].

4. CONCLUSIONS FOR INVESTORS

Because of the current relatively low level of intra-regional trade it is very likely that the AEC integration will considerably increase the amount of intra-regional trade. Companies that have already created a juridical entity in some of the member countries will most likely have several advantages over those that come after the results of integration start being felt. The massive infrastructure projects such as the Singapore–Kunming railway, the ASEAN Power Grid, the Trans-ASEAN Gas Pipeline, the ASEAN Maritime and the Open Skies Agreement, create opportunities for the candid investor. Figures 4 and 5 provide some indication of the strategic locations of these projects and what that entails, for example, for energy producers and non-ASEAN trade partners. Most of the researchers reviewed stressed the importance of creating and implementing effective policies. The current steps seem to be going in the right direction, but it is likely that intra-regional differences will remain significant for years to come; an indication of this is the phasing out of the sensitive list products for the CLMV countries in the AEC blueprint. The large differences between member states' labor wages can create problems in the future, but, being part of the free trade area, they also create opportunities.

The Busines-in-Asia (2013) analysis points out that even though China gets more publicity it might be unjustifiably so, as Thailand could exceed China as a location for investment and even Vietnam might be more competitive, especially when considering factors such as long term consistent government pro-business policies, the rule of law, the right to own land (as opposed to lease), mandated additional personnel benefits, tax incentives and quality of life for company executives [24]. The Busines-in-Asia (2013) claims furthermore that Vietnam is also a top choice for investors because of the work ethic of its people, low labor and other costs, government incentives, and an improving business and legal environment [24].

Only some of the claims made by Busines-in-Asia (2013) can be validated, and even within these assertions it should be remembered that these figures are highly subjective. When considering the World Bank's measures of Voice and Accountability, Political Stability and Absence of Violence, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption it seems that on average Thailand between the years 1996-2011 would have somewhat higher scores than China with the exception of Political Stability and Absence of Violence [25]. Nevertheless, with some good governance spillover effects from Singapore and a narrowing of some development gaps inside the ASEAN region, the AEC appears to have sound investment possibilities for the astute investor. The ADB (2013b) certainly believes that Asia is a massive energy market which provides opportunity and room to introduce and develop new energy technologies [26].

5. FUTURE RESEARCH

The review nature of this paper intends to open the doors to, and to identify, future research needs. There has been plenty of regression analysis on the ASEAN integration, but the author's research appears to indicate that the "soft" barriers (language, culture and institutions) to investment in the ASEAN region have not been sufficiently studied. Considering the importance of the subject to FDI and exports, gaining greater insights and clarity about such barriers would seem a worthwhile endeavor. In a perfect world the "soft" entry barriers should be compared besides intraregional with other meaningful trading partners that are outside the region such as the EU. Another related interest would be to study the learning curves in terms of language, culture and institutions of the companies that opt to venture into the region and compare companies with different cultural and institutional distance. A study of work ethics at least with the four factors used by Zhang Liu and Liu (2012): hard work, internal motive, admiration of work itself, and negative attitude to leisure [27], could also be an interesting indicator for national FDI analysis.

6. ACKNOWLEDGEMENT

I would like to express my gratitude to Dr. Paul Buschenhofen for reviewing the article and for his truly constructive suggestions. All the inadequacies left the author is to be blamed.

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