

## **CHAPTER II**

### **ASEAN ECONOMIC INTEGRATION**

This chapter explains the history of Association of Southeast Asia Nation (ASEAN). It will describe about the early establishment of ASEAN in terms of aim, scope, and membership. Then, this chapter gives description on the process of economic integration among the member states of ASEAN is formed. Two biggest milestones of ASEAN economic integration is the cooperation through ASEAN Free Trade Area (AFTA) and ASEAN Community through its ASEAN Economic Community that will be further described in this chapter.

#### **A. The Establishment of ASEAN**

ASEAN was established in August 8, 1967. However, before the official establishment of ASEAN there was a geopolitical cooperation and it interacted before the 1967. During the World War II, there was an establishment of South-east Asia Command (SEAC). In 1943, the SEAC was formed as the cooperation for alliance group of the war. At the end of the world war, SEAC was dismissed because the alliance cooperation was no longer needed. The aftermath for the dispersion of SEAC was followed by the independence of several countries, such as Indonesia. However, even SEAC has been dismissed, the term of Southeast Asia becomes commonly used by scholars or states (Smith, 2015).

The regional cooperation in the Southeast Asia started over again during the South East Asia Treaty Organization (SEATO), it aims to prevent communism. However, only two countries from Southeast Asia regions joined the organization. After the end of the cold war, they dissolved of the cooperation in 1977. According to the history, much cooperation among Southeast Asia member states was formed. However, only the one that was formed on August 8, 1967, the formation of Association of Southeast Asia that lasted until today and keeps developing its cooperation. The formation was marked by the signing of the Declaration of Bangkok by five representatives of the Southeast Asian States, Prime Minister of Foreign Affairs of Malaysia, Tun Abdul Razak; Indonesian Foreign Minister, Adam Malik; Minister of Foreign Affairs of Philippines, Narcisco R. Ramos; Singapore's Foreign Minister, S. Rajaratnam; and Minister of Foreign Affairs of Thailand, Thanat Khoman (Jamil Maidan Flores, Jun Abad, 1997).

Thus, the early cooperation was focused on the political aspects, on how the countries that belong to ASEAN maintain the peace and stability in the region. However, the regional cooperation develops and enlarges its scope in the following years. Besides the political and security concept, ASEAN is also developing its cooperation in the sector of socio-economic context. Then, besides the cooperation in the intra-ASEAN, ASEAN also conducts cooperation with several countries and institution.

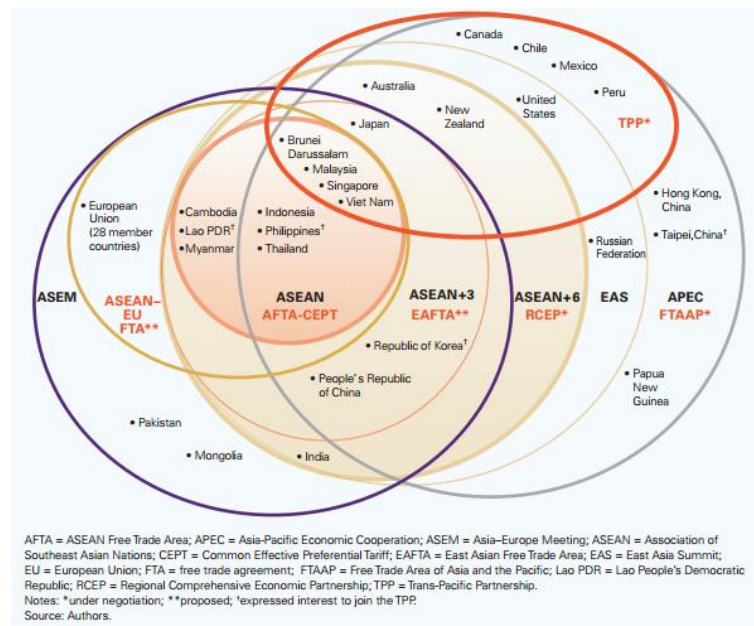


Figure 2. ASEAN External Relations (ADB Institute, 2014)

According to the diagram map of ASEAN external relations, during the development of ASEAN, much cooperation was formed with other countries. Through these partnerships, the ASEAN contested its interest with the dialog partners in the international system. Then, with the expansion of cooperation, ASEAN can expand its product of networks and bilateral cooperation. In several numbers of occasions, these dialog partners of ASEAN external relations have been discussed through the bilateral level then they continue the talk in the ASEAN forum at the regional level. Furthermore, the main aim of having the dialog partners is that ASEAN keeps intensifying its cooperation. The efforts are made by enlarging its focus of cooperation's sector and also the actors to cooperate with the ASEAN.

There are some cooperations made by ASEAN, For instance, the establishment of ASEAN Plus Three (ASEAN +3), in which, ASEAN focuses on

the economic matters with Japan, Republic of Korea, and People's Republic of China. The cooperation with this dialog partner was started in 1997 and continues in after years passed (Kementerian Luar Negeri, 2010). For now the cooperation is regulated on ASEAN Master Plan on ASEAN Connectivity.

Besides the establishment of ASEAN external dialog partners, ASEAN also created other regional groupings. The development of other regional groupings among ASEAN member states takes places because several external relations cannot be recognized with the membership of ASEAN. Thus, it is important for ASEAN Member States to form regional groupings outside the ASEAN and its dialog partners. The example of regional groupings are The Mekong Cooperation and CLMV (Cambodia, Laos, Myanmar, Vietnam). The Mekong Cooperation consists of Myanmar, Thailand, Laos, Cambodia, and Vietnam that emphasized on the improvement of transportation linkage in the Mekong Peninsula. Meanwhile, the CLMV cooperation has a goal to narrow their development gap towards other ASEAN Member States.

To understand the process of integration within the ASEAN, this research paper would like to give a description on the structure of ASEAN. This structure would lead to the framework making, monitoring and evaluating process of the ASEAN Economic Integration. According to the ASEAN Charter, the highest coordinating structure in the ASEAN is the ASEAN Summit, where the head of states issue important matter concerning ASEAN member states. The ASEAN Summit also refers to the supreme process of the ASEAN decision making process. Then, there is ASEAN Coordinating Council. This council meets twice a

year to prepare the ASEAN Summit. The Coordinating Council also functions to coordinate regarding the report from the ASEAN Summit and ASEAN Community Council.

ASEAN Community Council is a council which focuses on its work towards the implementation of the ASEAN Community. This council works with the ASEAN Ministerial Bodies from the Economic, Political Security or the Socio-cultural to implement the output of the ASEAN Summit and the progress of ASEAN Community.

Finally, there is ASEAN Secretariat where the member staff cannot be intervene from the ASEAN or the external parties from the ASEAN. In the secretariat, there are several departments and divisions working under the Secretary-General. Regarding the gap narrowing, there is the division of Initiative for ASEAN Integration and Narrowing Development Gap under the ASEAN Economic Community Department to monitor the disparities among ASEAN Member States.

## **B. ASEAN Economic Integration**

The ASEAN integration does not merely deal with the political sector, but also the integration on the economic aspects. It is a realization of potential resources to create an economic integration, such as the amount of population in the ASEAN member states. ASEAN consists of more than 600 millions of people, and it is still growing (Vinayak, 2014). It is the huge opportunity for market and also the resources of labor. ASEAN is claimed as the new promising region and

with the hope of these promising notion, ASEAN Member States could get benefit resulted from the economic cooperation.

In order to pursue the maximization of economic interest and expansion of its market, ASEAN established economic cooperation among its member states. Since the end of twentieth century, ASEAN created several initiatives of economic integration with its ultimate goal to focus on the establishment of single market and increasing the capability of facing the international market (Weatherbee, 2009).

The enlargement of cooperation on economic has the biggest step on the formation of ASEAN Free Trade Area (AFTA) in 1992, then it continued to the establishment of ASEAN Community, where there is the ASEAN Economic Community that focused on the economic cooperation and integration. The formation of AFTA was marked with the signing of Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area by the ASEAN-6 (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) in the Third Summit Meeting in Manila. The main aim of its establishment is to increase the ASEAN's market competitiveness by reducing the trade barrier.

It is stated in the agreement of CEPT-Scheme that by creating the reduction of trade barrier, it will stimulate the ASEAN economic resilience and expand the investment, production and trade opportunities (ASEAN Secretariat, 1987). As the agreement was agreed by the ASEAN-6, then, Vietnam joined in

1995, continued by Laos and Myanmar in 1997, and the last member states to join is Cambodia in 1999 (Kemendag, 2002).

Then, the second milestone of ASEAN Economic Cooperation is the establishment of ASEAN Economic Community (AEC). AEC is one of the pillars in the ASEAN Community, besides the ASEAN Political Security Community (APSC) and ASEAN Socio-Culture Community (ASCC). The establishment of ASEAN Community planned to meet its deadline in 2015. The ASEAN Community focuses on the creation of one ASEAN in the region, as it has the value of “one vision, one community, and one identity”.

The framework of ASEAN Community is officially written on the first ASEAN Community Blueprint. The blueprint is a document consists of working plans from 2009-2015. However, the establishment of the Blueprint has the extension after its official establishment on the 2015 on the ASEAN Community Blueprint 2025.

### **1. Economic Cooperation through ASEAN Free Trade Area**

The primary step of AFTA is the implementation on the scheme for tariff reduction in intra-ASEAN's trade. There are three main frameworks implemented in AFTA, those are the CEPT-Scheme, Protocol to Amend Protocol to Amend the Agreement on CEPT-AFTA for the Elimination of Import Duties, and ASEAN Trade in Goods Agreement (ATIGA). Firstly, tariff reduction was agreed on CEPT-Scheme . Then in 2003 ASEAN implemented Protocol to Amend the Agreement on CEPT-AFTA for the Elimination of Import Duties. Then, after seven years of the previous protocol, AFTA established ATIGA to reduce tariff

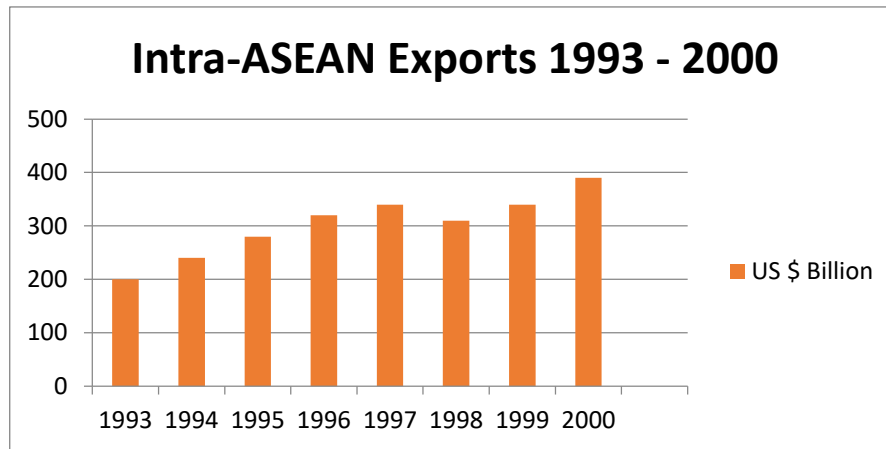
barrier. In order to prevent the trade disputes during implementing the AFTA's agreement, ASEAN Member States solves them through the bilateral discussion.

In the economic integration within AFTA, it imposes the principle of flexibility. This means that when a member state follows the regulation of CEPT to reduce its trade tariff for 0-15%, the member states were given deadline until 2003 to reduce their tariff (Kemendag, 2002). As CLMV countries become the latest member to join, there was an assumption that their respective industries will not be sufficiently prepared to face the forces of regional competition and unable to take advantage of the economic opportunities of AFTA (Hank Lim, Kim Maung Nyunt, 2010). Thus, ASEAN gave additional time for these countries to adjust with the tariff reduction scheme. It was the efforts from ASEAN to accommodate the delays in the inclusion of certain policies among the ASEAN member states.

According to the statistical data that was released by ASEAN Secretariat, after the implementation of CEPT scheme, there was the growth within intra-ASEAN trade exports from US \$ 44.2 billion in 1993 to US \$ 95.2 billion in 2000 (ASEANStats, 2013).



Table 3. Intra-ASEAN Exports 1993-2000



Source: Analysis Data retrieved from ASEAN Investment Report 2015

Besides the international trade, foreign direct investment also becomes a concern to liberalize the economic and create more enhance economic cooperation (WTO, 1996). ASEAN established an ASEAN Investment Area (AIA) Council under the ASEAN Ministerial Bodies in 2012. AIA has a role in succeeding the agreement of ASEAN Comprehensive Investment, where one of its focuses is to enhance the capacity of ASEAN and its Member States in the implementation of liberalization, protection, promotion, and facilitation of investment (ASEAN Secretariat, 2009). One of the key indicators in the investment sector is the growth of Foreign Direct Investment in the region.

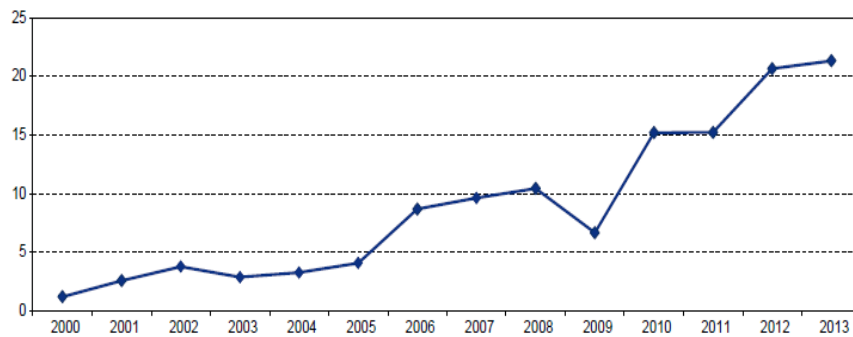
Foreign Direct Investment is defined as the process of financial investment of companies to certain country outside their home country. The policy of foreign direct investment is ruled and administered by the government of the home country. According to Stephen Cohen, the term Foreign Direct Investment can be elaborated, such as these definitions:

FDI is a financial activity that normally consists of an international capital flow from the home country to the host country for the purpose of acquiring partial or full ownership of a tangible business entity, such as a

factory, extractive facility, or wholesale distribution system. As a branch of international finance, FDI has implications for the balance of payments of both home and host countries.

FDI is the generic term used to designate the economic policies toward MNCs and international investment flows maintained by governments and international organizations. Finally, FDI is the generic term used by official statistical agencies to measure in monetary terms the annual incoming and outgoing flow and the cumulative value, that is, the stock of inward direct investments, on a country-by-country basis (Cohen, 2007).

Table 4. Intra-ASEAN investment (in Billion of dollars)



Source: ASEAN Investment Report 2013-2014

We can see from the graph above that there is a significance increase on the percentage of intra-regional investment within the ASEAN. This is also shown the rising of regional opportunities in the region. The establishment of AIA resulted the Intra-ASEAN investment. It is proven by the rose of 26% in the year of 2014, with the total money from \$19.4 billion in 2013 to \$24.4 billion in 2014. This number shows a growing interest of companies from the region of ASEAN in establishing a stronger regional presence, in particular in recent years after the establishment of AIA (ASEAN Secretariat, 2015).

## **2. ASEAN Economic Integration through ASEAN Economic Community**

In pursuit to grow the economic in the region among ASEAN Member States, ASEAN conducts more intense regional cooperation. During the 9<sup>th</sup> ASEAN Summit, the intention to establish ASEAN Economic Community (AEC) was expressed on October 7, 2003. According to Declaration of ASEAN Concord II (Bali Concord II), the primary goal from the establishment of AEC is:

The realization of the end-goal of economic integration as outlined in the ASEAN Vision 2020, to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in year 2020 (ASEAN Secretariat, 2003).

Even though both AFTA and AEC are the economic cooperation in the region of Southeast Asia, but AFTA focuses on the elimination of trade barriers in the region. Meanwhile, the establishment of AEC vision aims to create more inclusive economic regionalization. Thus, the ASEAN Member States envision more enhancements in the cooperation that involve the flow of human resources, integrating industries in the region and invite the private sector to involve in this cooperation. Therefore, it can be concluded that the ASEAN Free Trade Area was the initial form of ASEAN Economic Community.

According to figure 2 of the ASEAN Economic Community milestone, to support the realization of Bali Concord II about the establishment plan of ASEAN Community, the ASEAN also established an Initiative of ASEAN Integration. The aim of the establishment is to help newer ASEAN member state to be equally shared to the CLMV Countries, and also help them in implementing and ensuring the benefit of ASEAN integration.

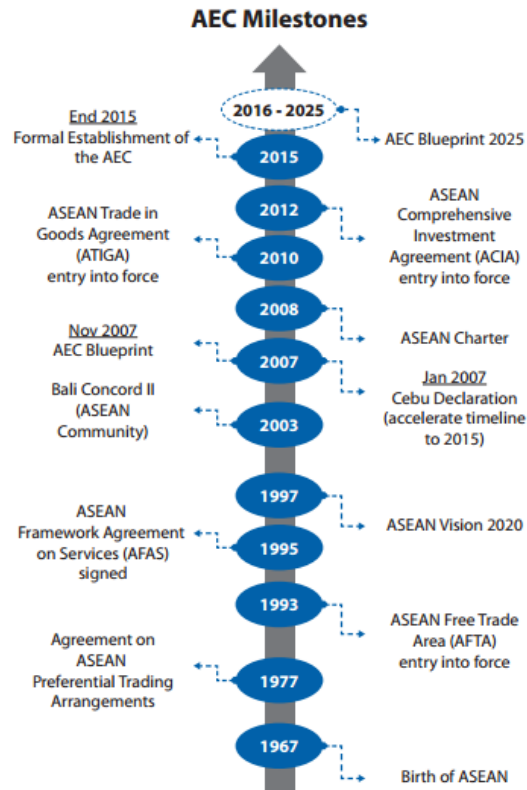


Figure 3. The Timeline of ASEAN Economic Community Establishment  
(ASEAN, ASEAN Official Twitter, 2016)

The initiative is related to the economic integration since it was released after the Bali Concord II. However, the initiative is more focused on the latest member states in the ASEAN. Then, the establishment of the initiative is also related to the efforts of ASEAN in enhancing the economic cooperation through ASEAN Economic Community.

In ASEAN Economic community, there are several pillars agreed on the blueprint to be realized. The main pillars of ASEAN Economic Community are:

- (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. As broad and multi-faceted as

these are, the goals of the AEC have already been met on many fronts. (ASEAN, 2015)

Those pillars have different goals in order to create the better economic cooperation within the ASEAN Member States. The first pillar seeks the achievement by establishing the free flow of goods, services, investment, skilled labor and freer flow of capital. It intends to provide bigger opportunities to trade for its population, as ASEAN has more than 600 million of population. Then, the second pillar is defined as the effort for this regional to create the business-friendly environment. The third pillar goal is to create sustainable growth and development. It will be realized by encouraging the Small and Medium Enterprises to participate in the national level. This pillar also focuses on developing the newer member states of ASEAN. Finally, the fourth pillar is the main framework to pursue the ASEAN's external economic cooperation by enhancing the free trade areas and comprehensive economic partnership agreements (ASEAN Secretariat, 2015).

The Secretariat has the mechanism of AEC Scorecard to report the progress of implementing various AEC measures, identifies implementation gaps and challenges, and tracks the realization (ASEAN Secretariat, 2012). However, there is no special agency to enforce when the target is missed. Thus, to implement the Blueprints needs huge efforts to commit on the establishment of AEC. Then, it is concluded that major delays of implementing the AEC Blueprint come from:

- (i) ratifying signed agreements and protocols — thus delaying effective implementation,
- (ii) completing specific country commitments,
- (iii) revising domestic laws, rules, and regulations to align them with AEC

requirements, and (iv) implementing specific initiatives and measures. An assessment of current delays and their importance in meeting targets underlines the AEC challenge. (ADB Institute, 2014).

Before reaching the year of 2015, the implementation of AEC was divided into several phases based on the year to monitor and evaluate the progress. The accomplishment was divided into Phase I (2008-2009), Phase II (2009-2011), Phase III (2012-2013), and Phase IV and Phase IV (2014–2015). The data of the AEC Scorecard from Phase I (2008–2009) was 86.7%. Then, the accomplishment rate of the Phase II (2009–2011) rate fell to 54.6% (ADB Institute, 2014). However, the Scorecards for Phase III and IV were not published for public (Jayant Menon, 2015). Even though the ASEAN Secretariat has various publications on key achievements of before AEC 2015, such as the ASEAN Annual Report 2013-2014 which was published in the end of 2013, there is no systematic report like the AEC Scorecard from the Secretariat. Hence, there are no tracked reports on improvement of each pillars of AEC.

It was reported that ASEAN reached level 80% its goals have been achieved, in which, country with the most advanced progress is Singapore (Fernquest, 2015). Thus, the least developed countries, especially the CLMV countries should catch up to realize the goal of AEC. Thus, it is valued as a need of “external assistance and ensure the capacity of integration” to speed up their progress. Then, it becomes the concern of ASEAN to put concern on the capacity of the CLMV to participate in the AEC (Scorecard, 2010).

### **C. Future Goals of ASEAN Economic Integration**

In the end, for the shortest time period the goal of ASEAN economic integration is on ASEAN Vision 2020. ASEAN Vision 2020 is one of ASEAN's legal frameworks that was agreed in Kuala Lumpur on December 1997. This framework mainly focuses on the economic growth and cooperation within the ASEAN.

The ASEAN 2020 also has ambitious action to resolve the advance economic integration and cooperation by fully implementing on the liberalization of trade in goods and services. It stated the commitment of ASEAN Member States to have “closer cohesion of economic integration, narrowing the gap in the level of development among Member Countries, and ensuring the multilateral trading system in order to achieve global competitiveness” (ASEAN Secretariat, 2012).

Furthermore, there is another deadline for ASEAN, which is the AEC Blueprint on 2025 as it is envisioned after the establishment of ASEAN Economic Community. The implementation of AEC has been a progress, for instance, to facilitate regional trade, to promote connectivity and to advance the service trade liberalization agenda. Meanwhile, the establishment of the AEC Blueprint 2025 is to reinforce unfinished task within the AEC Blueprint 2015 by the end of 2016 (ASEAN Secretariat, 2015).

Moreover, there are many legal frameworks that were established and agreed by ASEAN in order to fulfill the idea of ASEAN Vision 2020. For instance, the framework of Initiative on ASEAN Integration (2000 and 2009) and

the Declaration on Narrowing Development Gap (2001) which aims to decrease the economic disparities, as it is being described in the Chapter 1, where the regional inequality that caused by economic disparities become an obstacle to reach the integration and cooperation of economic among regions.