

# FOCUS



## ASEAN ECONOMIC COMMUNITY: a Prologue

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The ASEAN Economic Community (AEC) is one of the three pillars of the ASEAN Community. The Leaders of ASEAN Member States has signed the AEC Blueprint in 2007 as a guideline to establish the AEC by 2015. Based on the AEC Blueprint, there are several key characteristics of the AEC, namely a single market and production base, a highly competitive economic region, a region of equitable economic development and a region fully integrated into the global economy.

Each of those key characteristics consists of some core elements. As an example, there are five core elements in the first key characteristic, i.e. free flow of goods, free flow of services, free flow of investment, free flow of investment and free flow of skilled labor. This article aims to present several interesting features of the AEC which are summarized from the AEC Blueprint. Moreover, a simple analysis on the openness of the ASEAN Member States is also presented by using two indicators, namely the standard openness indicator and the size-corrected openness indicator.

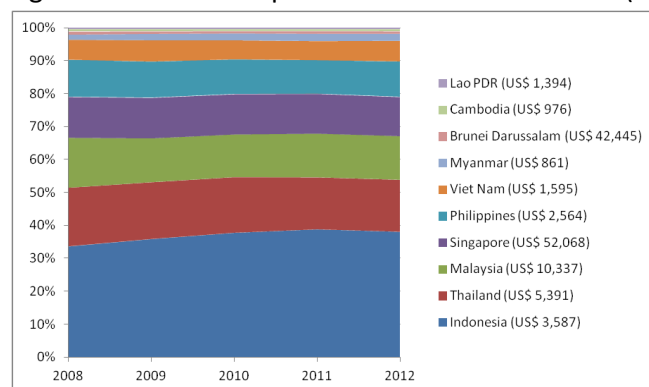
In order to establish a single market and production base, ASEAN will not only focus on the removal of tariffs, but also the elimination of non-tariff barriers, improving trade facilitation and implementing ASEAN single window (ASW). The ASEAN Free Trade Agreement (AFTA) has been in effect since 1993. Up to 2010, ASEAN-6 had been eliminated nearly 100 percent of the tariff lines in the Common Effective Preferential Tariff (CEPT). ASEAN new members also made significant progress by reducing their tariff to 0-5 percent in more than 95 percent of the tariff lines. The ASW is another breakthrough initiative by the ASEAN Member States. The Member States of ASEAN will be able to exchange cargo information data securely and reliably through the ASW in order to make cargo clearance process faster. Moreover, the ASW uses international standards that allow the ASEAN Member States to exchange data with any other trading partners as long as they use the same international standards. In April 2013, the ASW had successfully tested in seven ASEAN Member States. After full implementation of the ASW, the clearance among ASEAN Member States will be changed into a paperless procedure.

The AEC is expected to transform ASEAN into a competitive economic region through improvement on competition policy, consumer protection, intellectual property rights, infrastructure, and avoiding double taxation among all ASEAN Member States. The ASEAN Open Skies agreement is one of the

strategies to improve competition and connectivity (through infrastructure) among ASEAN Member States. This agreement will create a big opportunity for airline services to expand their business and offer more flight routes within the ASEAN region. However, there are some challenges remained as mentioned by Karamjit Kaur (published in the Jakarta Post, 28/02/2014). First, not all ASEAN Member States has ratified the Open Skies Agreement. Indonesia as the biggest country within the region both in terms of national output and population has not ratified the agreement yet. It might be due to the fear that its local airlines cannot compete with foreign airlines. Second, the readiness of supporting infrastructures is far from ready. One of the examples is Soekarno-Hatta airport in Jakarta, Indonesia. Currently, it has only two runways and a total capacity of 22 million passengers. However, this airport has served around 62 million passengers in 2013 which is nearly three times larger than its capacity.

An initiative on Small-Medium Enterprises as part of AEC is expected to narrow the disparity between the ASEAN Member States. As previously mentioned, Indonesia is the biggest economy within the region. Figure 1 suggests that Indonesian national output contribute about 35 percent of total ASEAN output. Meanwhile, the share of Lao PDR and Cambodian national output is only 0.3 percent and 0.6 percent respectively. In terms of GDP per capita, the income gap between the ASEAN Member States is significantly big. Singapore is the richest country within the region with a GDP per capita of US\$ 52,068 in 2012 and it is followed by Brunei Darussalam with a GDP per capita of US\$ 42,445. Meanwhile, Myanmar and Cambodia are the poorest countries within the region with a GDP per capita of US\$ 861 and US\$ 976 respectively.

Figure 1. National Output of ASEAN Member States (as percentage of total ASEAN GDP)



Source: ASEAN Macroeconomic Surveillance Unit Database

The AEC is not the final goal of ASEAN's dreams. ASEAN Member States are willing to increase their integration into the global economy by maintaining ASEAN centrality. Several free trade (FTAs) negotiations have been conducted with non-ASEAN countries, such as Australia, New Zealand, China, India, Japan, and the Republic of Korea. Individually, several ASEAN Member States has been actively involving in the negotiation of much larger FTAs, such as four ASEAN Member States (Brunei Darussalam, Malaysia, Singapore and Vietnam) in the Trans-Pacific Partnership Agreement (TPP).

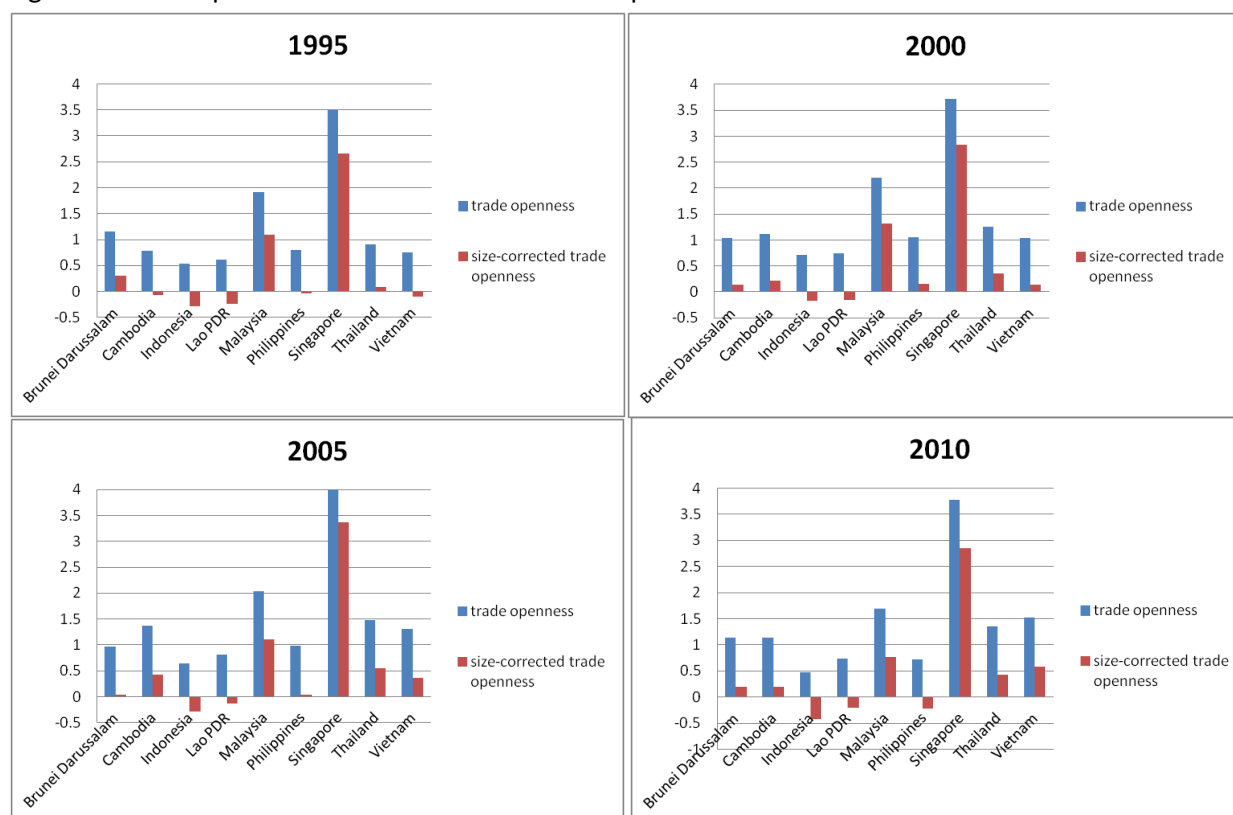
ASEAN Member States are relatively open to the global economy based on the standard openness indicator. However, if the size-corrected openness indicator is used, the results suggest that several ASEAN Member States are actually dosed economy countries. Bretschger and Hettich (2002) argue that

the standard openness indicator may lead to biased analysis since smaller countries tend to have higher trade shares than larger countries. Thus, a modification on the standard openness indicator is needed. This article also presents size-corrected trade openness indicator based on the procedures in Bretschger and Hettich (2002).

Figure 2 shows that Singapore and Malaysia are relatively open to the global economy based on both the standard openness indicator and the size-corrected trade openness indicator. The most interesting cases are Vietnam and Indonesia. In 1995, Vietnam had a size-corrected trade openness indicator below average for the sample countries (negative value). Then, Vietnam has transformed itself into an open economy with a trade openness value larger than Thailand both for standard and size-corrected indicator. The value of standard openness for Indonesia is between 0.4-0.7, which implies Indonesia is an open economy. However, if we consider the size-corrected trade openness indicator, Indonesia is a closed economy with a size-corrected openness value smaller than zero.

It has been seven years since the signing of the AEC Blueprint and next year will be the most important year for the ASEAN Member States. The AEC is expected to take effect by the beginning of 2015. Are they likely to attain all the aspects of the AEC? More analysis on the progress of the AEC will be discussed in the next volume.

Figure 2. Trade Openness and size-corrected trade openness



Source: WDI, author calculation