

ASEAN ECONOMIC COMMUNITY (AEC) AND REGIONAL COMPREHENSIVE ECONOMIC PARTNERSHIP (RCEP) IN A CHANGING GLOBAL CONTEXT: IMPERATIVE OF DEEPENING AT AN ACCELERATED PACE

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Dimensions of Incomplete Success

Recognizing the way regional integration and cooperation has evolved in recent times in East Asia (EA) defined as ASEAN and its six partner countries in the ASEAN Plus Six it increasingly makes sense to look at EA as a region with ASEAN or Southeast Asia (SEA), Northeast Asia (NEA) and Australia, India and New Zealand (AINZ) being sub-regions. Growth indicators, trade indicators, foreign investment indicators, statistics on the flows of people and the way the rest of the world (ROW) looks at EA confirm convincingly that it is more proper to look at EA as a region rather than its smaller geographical parts.

Generally speaking this emerging region is currently serving as the pivot of the world economy for a number of reasons. It is growing faster than the rest of the world, the developed and the less-developed parts. Future potential for growth is also more promising in EA than in the rest of Asia, Europe, North America, Latin America, and Africa. Attention of traders, investors, job seekers and governments is therefore focused on EA. They all wish to benefit from the EA growth. However, EA is not a homogeneous region. While strong growth is shared widely among countries therein stark contrasts prevail on many accounts, making EA a region of a very high complexity.

The contrast starts at the level of income and economic development in general. On this score EA occupies the entire spectrum of income and development levels. At one end EA is home to countries of very low or low income like Myanmar, Cambodia, and Lao, PDR. On the other hand it is also home to top-income countries of different kinds like Brunei Darussalam, Singapore, Japan, and the Republic of Korea (ROK). In the lower middle there thrive Vietnam, India, the Philippines and Indonesia behind Thailand and Malaysia in the upper middle. Beyond the favorable economic growth there looms very large in East Asia different priorities of economic policy making, including economic community building, even though overall EA as a region is widely pictured as the prospective region in the world economy.

While seeking to push and sustain economic growth governments can resort to basically two groups of policies: macroeconomic policy to address cyclical fluctuations and complex structural reforms to deal with long-term growth. Both of them are important, noting the fact that an economy is always faced simultaneously with cyclical changes and long-term structural changes. In cases where change in government occurs periodically and often time results in new policy macroeconomic fine tuning plays a very important role. However, room for fine tuning differs greatly from one economy to another. Many governments can hardly move because of excessive stock of debts and borrowing. The situation is more favorable in EA.

Inflation is largely benign in EA. Yet Vietnam and India are faced with the risk of it rising to become double digit. The recent currency depreciation following the anticipated tapering of the quantitative easing in the United States (US) also raise the level of inflation in some other countries like Indonesia. Interestingly EA has widely adopted anchoring such as inflation

targeting in dealing with inflation, uncoupling from the pragmatism that is usually associated with policy making in EA. Thanks to such determination inflation is less of a threat to EA. Encouragingly, unemployment is also low. The so called misery index or the sum of inflation rate and unemployment rate is also low. As always there is variation between countries. India in recent time is faced with an employment rate of almost 10 percent. What is more there are important footnotes to unemployment in EA. Open unemployment is obviously not the core of unemployment problems in many EA economies. Underemployment is at least as important as open unemployment. Huge number of jobs is vulnerable and can disappear when a shock occurs.

Closely related with inflation and unemployment is poverty. What EA has accomplished in this respect in recent times is perhaps one the most encouraging features of the world economy. With the remarkable economic growth in the entire region, particularly in its populous parts of China, India, Indonesia, the Philippines and Vietnam the region has managed to free a huge number of people out of poverty. Yet, the war against poverty is far from won. If poverty line is defined at PPP USD 2 per day, around 68 percent of Indians, 60 percent of Laotians, 49 percent of Cambodians, 43 percent of Indonesians and Vietnamese and 27 percent of Chinese still struggle at the edge of poverty. Furthermore, inequality is worsening in the region as reflected in rising Gini Coefficients. Apparently, high wages in the region are catching up with high wages in higher-income countries while lower wages are pulled down toward the level that prevails in lower-income economies, reflecting to some extent the labor market realities in the region. To an important degree the inequality is perhaps explained by the early stages of development which is expected to soften as per capita income rises.

The relatively favorable macroeconomic condition in EA applies to some other key indicators. Governments in EA are less heavily indebted than many others in the ROW. Government debt-to-GDP ratios are low or very low. Japan is an exception where it may have exceeded the 200 percent margin. Yet, even in the case of Japan the government can still depend on huge domestic saving to finance the huge debt, although sooner or later Japan too will be forced to bring debt to a much lower level through the combination of expenditure cuts, tax increases and asset sales. Such fiscal restructuring will have to occur at a time when ageing exacerbates with all the unavoidable burdens to government finance. As for the rest of EA low government debt is also not a total blessing. It comes at the cost of infrastructure which is acutely inadequate in EA.

Somewhat more disquieting is the profile of current account. After a long period of positive current account after the crisis of 1997-1998 in the wake of stringent austerity Indonesia has returned to a negative current account in 2014, creating some nervousness when the current account deficit combined with a negative capital account which resulted from the expected liquidity tightening in the US. Faced with the nervous financial market, Bank Indonesia raised interest rates. Reform is also being undertaken in the real sector with the aim of making Indonesia more attractive to foreign direct investment. The situation is more serious in Cambodia and Lao, PDR where the ratios stand at around 6 percent in recent time or far above to perceived tolerable limit of 4 percent, though these two countries can still count on development assistance while dealing financing. In India the current account deficit is much higher in the neighborhood of 8 percent. For a large economy such as high current account deficit is a reason for concern, however optimistic one may be about unrequited transfer and

direct investment inflow and incoming portfolio investment. Apparently, the current account deficit is of comparatively recent nature. Overall net investment position in EA is not worrisome. Australia and New Zealand exhibit a net position of – 64 percent and – 69 percent of GDP respectively, but are able to mobilize capital inflows in sufficient magnitude. For these two countries, refinancing does not appear to be a serious problem. Next in terms negative investment position is Indonesia at – 36 percent, ROK at – 18 percent, and India and the Philippines at – 10 percent each. On the other hand China enjoys a net position of + 37 percent, Japan + 56 percent and Singapore a huge + 224 percent. These statistics on net foreign investment position suggests indeed the importance of monetary policy cooperation that includes provision on reserve pooling. East Asia is on track with the strengthened Chiang Mai Initiative Multilateralized (CMIM) and the ASEAN Macroeconomic Research Organization (AMRO) as a seed of a more comprehensive monetary policy cooperation which in the course of time can evolve into one comprehensive macroeconomic policy cooperation.

Of equal importance to future growth is progress in community building in EA. Such progress can never be overemphasized in the current context of East Asia. The fact that EA has evolved into the world's most dynamic region is related to a very important degree to the persistence of peace and stability in the last episode of over 30 years. Trust capital was accumulated in the region with little disturbances. Even though EA countries were largely globalist up until recently or even perhaps currently, stronger community building provides economies of scale that the region can continue to enjoy while advancing the global production network into a higher sophistication. What is more, larger scale that results from community building allows economies to deepen division of labor to its limits and to come to the static benefits of lower

production and distribution costs as well as the dynamic benefits when specialized producer discover different ways of doing things. More fundamental arguments relate to geopolitics in evolutionary sense. The term EA is a historical concept, not a natural one. Borders in EA are also drawn by men, particularly men from outside EA. In other words borders in EA are related to historical accidents in many cases. They are not insurmountable obstacles to the sharing of markets and pooling of resources for mutual benefits.

After lagging for decades behind Europe in terms of regional integration and cooperation EA has caught up fast in recent years. Not only was the reluctance to integrate and cooperate greatly overcome among ASEAN countries in 1992 with the establishment of the ASEAN Free Trade Area (AFTA), ASEAN has evolved to an ASEAN Economic Community (AEC) which is scheduled to complete one stage by 2015. Intra-ASEAN trade, investment and flows of people have expanded, though one has to note time and again that EA rather than ASEAN is the more proper definition of region. Assessment by ERIA suggests that the agreed targets may not be attained in their fullness. Nevertheless, AEC is likely to deserve a “B” score with targets in trade in goods achieved to a large extent, though the ones pertaining to services, investment and flows of people much less so. Mention must also be made with the adoption of the ASEAN Charter in 2007. In spite of its limited ambitions in terms of extent and speed of integration and cooperation that go beyond inter-state relations the Charter gives ASEAN a more solid foundation as a regional grouping. In the meantime ASEAN is preparing for strategies and steps for post-2015 period which is likely to turn out to be critical for future economic development of ASEAN and EA in general.

Branching out of ASEAN regional integration and cooperation have also progressed in EA. Bilateral FTAs or partnerships have been established or are in the making in EA. The Chiang Mai Initiative has resulted in a much sizeable reserve pooling and a much more substantive framework of macroeconomic cooperation, though the CMIM is yet to pass its litmus test. The fact that the CMIM is equipped with mechanism which reflects the resourcefulness of the member economies in addition to the simple principle of one state one vote points out to the ability of EA to respond flexibly to changing circumstances. The CMIM must have played a role in protecting EA from the often time wild impacts of global crises like the one that erupted in 2007-2009 in the economies with the most developed financial system. The various attempts to pursue an EA-wide approach to regional integration and cooperation have also resulted in the launching of negotiation on RCEP which also is scheduled to come to an agreement by end 2015. What is more, intra-EA economic interactions have proliferated even stronger than what formal regional agreements promise to do. It is extremely important for EA to insulate the rising trade, investment and flows of people and the economic community building from the impacts of disputes in other spheres of life, particularly territorial disputes and arms built-up. Not only is such insulation very important from the perspective of future growth, it is also one way of raising stakes in good and peaceful relations as functionalists and neo-functionalists have argued all along.

The Next Stage of Graduation

Notwithstanding progressive growth in recent decades and the positive perception of EA among traders, investors and governments as the world's most promising region where a

presence is considered a must the fact remains that EA stretches from the very high points in the development ladder to a very low end. Even Japan is faced with need to revive growth to a higher level as reflected in the program of the new government. As the problems of ageing get increasingly severe and policy stance regarding immigration remains a closed one, the need for higher productivity of working population will be felt more pressingly, eroding even further the appeal of low-value processes in manufacturing and services. South Korea is challenged to replicate more widely the success of some companies through technology innovations. Similar to Japan, ROK will also have to raise productivity of working population to be able to absorb the burdens that come along with worsening ageing. Given its very high income Singapore may find it increasingly difficult to sustain a growth in per capita income. Brunei Darussalam may have little urgency to seek alternative growth sector outside oil and gas thanks to resource abundance and small population. It remains an open question whether or not the very advanced economies of EA will be in time to find the necessary growth impulses or whether or not the economies with rising old-age dependence will have to succumb to the tyranny of life cycle and be satisfied with a steady state.

For the rest of EA growth will continue to rank very prominently in development agenda. Indeed, the attainment of an escape velocity that would allow these countries to safely overcome the development traps is an imperative, if the lessons from the Japanese, Korea and China apply to the rest of EA as they probably do. Needless to say the challenges facing individual countries differ depending on physical geography, demography, cultures adhered to, level and diversity of competencies mastered by the population, the stage of development occupied, and economic systems adhered to as pertain to constitution of ownership, the role of

the state in economic development and openness to the ROW. To highlight the problems more succinctly the following discussion is focused on the more populous countries.

Experiences of Japan, ROK and China show that a sustaining progressive growth in manufacturing is indispensable to the attainment of the escape velocity of growth. A casual observation of the recent pattern in the global production network shows in fact that the acceleration is possible only in a few sub-sectors, notably information and telecommunication technologies (ICT), automotive industries and some parts of the consumers' goods industries. It is in these few industries where growth of output and trade is fastest. It is also in these few industries where division of labor can be pushed to its limits. A fundamental question may arise as to the extent to which the world can accommodate a rapidly growing manufacturing. In China, India, Indonesia, the Philippines, Myanmar and Vietnam. Whichever way one answers the question the countries are going to look at manufacturing as the only feasible locomotive for output and employment. Some may push the acceleration under state leadership along the line of industrial targeting, though the probability of pursuing such route successfully has diminished. The more popular route, however, is acceleration driven by foreign direct investments. In fact the strategy of creating momentum of growth through special economic zones where speed of development can be raised and location cost reduced through special administrative provisions and economies of scale and scope, is still a popular feature of policies to boost the growth of manufacturing.

Using foreign investment as catalyst of progressive growth in manufacturing requires a good policy in the widest sense of the word. Such policies include border measures that allow the

inflows and outflows of goods and services to proceed at high speed and lower cost across the different locations in the production network. On this score the developing parts of EA have a lot to catch up in addressing non-tariff measures related to trade in goods, including the setting and enforcement of various standards. Of equal importance is domestic regulation. The difficulties involved in infrastructure lie for instance partly in land rights. In some countries like Indonesia dealing with labor unions has turned out to be difficult with the tendency of unit labor cost rising progressively. Complying with regulations dealing with the ease of doing business has remained contentious despite efforts on the side of government to streamline the processes. Demand is also escalated by governments for quick transfer of technologies at a time when local companies have not been adequately prepared. What is more, underinvestment in infrastructure is generic to developing parts of EA. Routine expenditures, including subsidies on current consumption like fuels in the case of Indonesia, are typically large as fraction of tax revenue. The call for private investment to infrastructure by way of Public Private Partnership (PPP) has not materialized in dependable contracts, not to speak of large inflows of investments. As a result connectivity leaves a great deal to be desired. The decision by some governments to focus on a carefully selected cluster of metropolitans as Indonesia promotes through the “Indonesian Master Plan for the Acceleration of Economic Development” at appears sensible, but the Plan was watered down when it extends to virtually the entire Indonesia.

Given a tough competition between different locations the temptation may even harden to engage in what is called a “race to the bottom” or location dumping as a way of getting a larger share in foreign investments in manufacturing. The more thinly is a government equipped with

resources, the greater such temptation becomes. The danger of governments engaging in zero-sum games or even negative-sum games is apparent. Interestingly, ASEAN has recognized this danger from early on. It was with a view to minimizing such zero-sum games that the first substantive cooperation programs in ASEAN were largely in form of “resource pooling” in form of ASEAN Industrial Projects, ASEAN Complementation Projects, and ASEAN Industrial Joint Ventures. Market sharing was originally designed to complement the resource-pooling program apart from modest Preferential Trade Agreement with very limited margins of preferences. Unfortunately, none of the resource-pooling programs turned out to be a big success that could catalyze cooperation in the upstream and downstream industries. In the end ASEAN too opted to go the standard route of trade liberalization in harmony with unilateral trade and investment deregulation of the 1980s and 1990s.

There are certainly areas where liberalization initiatives need to constitute an important part in ASEAN and RCEP integration and cooperation. The obvious areas include the sensitive and highly sensitive lists of AEC and the trade or partnership agreements that emerged out of ASEAN. They need to be further reduced to a minimum in order not to work as a drag to integration and cooperation. The positive effects of opening are likely to produce the greatest effects in the sectors of exclusion. However, two other areas are of equal importance or even more important to lowest-income countries in ASEAN and RCEP: facilitation and functional cooperation related to capacity building.

ASEAN Economic Community and RCEP are certainly not exclusively aimed at accelerating and sustaining growth. It is at the same time designed to allow less-developed members to growth

faster or to catch up. Liberalization has social flaw in that it benefits the most prepared members and companies first while the less prepared have to wait for their turn. AEC and RCEP are also about reducing environmental stresses, both of immediate and long-term relevance. East Asian cities are suffering from severe shortage of fresh water, traffic jams, depleted public amenities, polluted air, green house gas emission and many other ecological stresses. Reforestation is badly needed in EA. Concrete measures are needed to protect land marine biodiversity in EA. The list is endless. Yet, little is likely to happen unless environmental policy is harmonized with growth policy, particularly in countries on the lower tail of the development ladder. Pairing growth with reduced environmental strains is a herculean challenge to ASEAN and RCEP. Enormous inputs are needed from scientific and applicative researches to discover such opportunities.

Measures of Inclusion and Sustainability under a New Regional Architecture

Regionalism is a dynamic process. Post-war experiences clearly show its tendency to spread to a wider and wider geographical coverage. New members accede to existing groupings and the European Union (EU) expanded from original six members to twenty seven and ASEAN from original five to ten. After all, region is a man-made term as alluded to earlier. An inter-regional integration and cooperation is also conceivable as ASEAN and the EU wanted to pursue at one time. The possibility of convergence between RCEP and TPP is of late often mentioned as building blocks for Free Trade Agreement of the Asia Pacific (FTAAP), even though the ways of doing that remain a big puzzle. Likewise issues addressed in regional integration and cooperation, get increasingly comprehensive over time. The EU evolved from a sector

community to single currency. ASEAN also went through a somewhat similar process in terms of issues that it deals with. The geographical extension and functional widening in issue coverage are hard to resist. As the number of members increase and linkage of issues gets increasingly complex, drawing an agenda becomes very difficult.

No issue is easy to deal with in a region as diverse as EA. However, the three blocks of issues involved in regional comprehensive partnerships do differ in the extents to which they have been dealt with. The liberalization block, while not easy, has been dealt the most intensively in history of regional integration and cooperation. Barriers to trade in goods, and to a lesser extent, services have been studied, quantified and assessed in terms of costs and benefits under liberalization for over six decades. Facilitation follows liberalization and is more or less pushed ahead following any major steps in liberalization. Of the least well understood is functional cooperation of capacity building nature. How can members like Lao, PDR, Cambodia and Myanmar can benefit from regional trade liberalization when they have very little to offer in terms of tradable goods and services? A similar question can in fact be raised in relation with the least developed parts of an emerging economy like the East provinces of Indonesia where tradable is typically confined to natural resources which can only be explored, exploited and traded with the help of huge financial capital and well educated and trained workforce. Such sectors are typically controlled by large multinational companies, alone or in cooperation with well-connected national companies. Areas of this type are hardly accessible to people living in least developed provinces of an even emerging economy.

On the other hand regional integration and cooperation are typically limited in terms of available human and financial resources. Most regional groupings are not equipped with the power to generate revenue. Their workforce also depends in most cases on the discretion of national governments. ASEAN and RCEP are no exception in this regard. In fact resource constraints are even tighter in ASEAN and RCEP compared for instance to the EU. This brings us to a very difficult question about a cooperation agenda which is meaningful enough for the immensely large region and population on the one hand but realistic enough in terms resource constraints.

Obviously some issues can only be dealt with in a meaningful way on a global basis. Climate change or atmospheric common in general belongs to this group of issues. Even if a region acts to reduce emission of GHGs the impact is unlikely to matter, if other regions do not act along. Perhaps, the same applies to issues of cyber common. On the other hand some issues can be addressed in an effective way. Industrial pollution and fishery management seem to belong to this type. The pre-competitive stage of industrial policy can also be included in this group of issues. Other types of issues can be considered national rather than regional. They include many health issues and transportation issues, including some issues of connectivity. Admittedly it is increasingly hard to demarcate the different groups of issues. Every important issue is increasingly taking the form of layered pyramid involving the three levels of issues at once.

ASEAN and its partners in EA and the ROW have initiated countless number of cooperation projects, large and small. Some of them seem to have greatly contributed to stronger interdependence in the region. However, some appear to be lacking or seriously inadequate.

One that seems to deserve a very strong attention is cooperation in science and technology (S&T) for a number of reasons. First of all, long-term sustainability of growth depends a great deal on progress in science and technology as practiced in business, households, public facilities and governments. Even a successful transition from lower middle-income to upper middle-income and from there to high income status is only possible with the help of S&T progress. In its absence economic activities will have to rely on factor addition which is notoriously short-lived as source of growth. Secondly, it is in respect of S&T literacy and capabilities that countries in ASEAN and RCEP differ very starkly. Sources from UNESCO suggest that research and development (R&D) capacity in most countries of ASEAN and RCEP is very limited compared to the few leading S&T countries of the region. Given this limited R&D capacity the countries can offer very little as possible contribution to R&D collaboration of regional and global scopes. In the universe of international R&D collaborations only a few countries in ASEAN and RCEP have participated. If this trend continues there is little than one can expect in terms of development convergence of a lasting nature in the region.

Possible areas for S&T cooperation in general and R&D cooperation can be very vast. To come to a matrix of meaningful programs countries in ASEAN and RCEP are well advised to come up with their respective intents which can then be put together into a regional matrix at ASEAN and RCEP levels. Such programs should not be conceived as a transfer program. Even under the tight resource constraints that each country is faced with active participation in form of human and financial resources should be required of all participants. While participation of all countries should be encouraged, the formula of ASEAN Minus X or RCEP Minus X should also be accepted in the interest of progress.

Finding new levers for cooperation is critical to success, but is perhaps the most difficult task to perform. Theoretically one element of levers is better information of stakeholders. On this score AEC and RCEP suffer from a big gap being largely a state-driven undertaking. Change is needed on this score, recognizing the power hidden in open system. The second element relates to institutionalization. ASEAN and RCEP rely heavily on ASEAN centrality. Yet ASEAN is faced with tight limitations. It still is largely an association of nations rather than a region when it comes to policy decisions, implementation and supervision. Financially, ASEAN is also much more limited than its ambition suggests. Hence, ASEAN and RCEP are faced with the need for institutional reforms, taking into consideration effectiveness of process on the one hand and respect for nation state on the other. Needless to say, leadership is important. Historical circumstances force EA to continue to rely on ASEAN as the mover of EA regionalism as it has done over the years. Yet, a more inclusive leadership appears to be increasingly needed. The CMIM arrangement where voting is weighted by taking into account members contribution, provide possible model to learn from. An exclusive reliance on the principles of one country one vote will allow community building in EA to proceed at slow pace only.