

East Asian Economic Integration and Europe: Can ASEAN Learn from the EU?

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Core University Program Conference 2006
"Emerging Developments in East Asia FTA/EPAs"
October 27-28, 2006
Kanbaikan Hall
Doshisha University

Summary of Presentation

1. Overview of Evolution of ASEAN Institutional Integration up to AEC
2. Analysis of European Lessons for AEC
3. Recommended Approaches for AEC

I. Evolution of ASEAN Integration

1. ASEAN Integration at first was superficial, and this was fortunate: direction was wrong (and this is true for certain existing developing country groups today)
2. "Serious" approaches to integration began late 1980s, when political exigencies receded
3. AFTA was milestone in regional integration, both due to its being first FTA in Asia and its "policy signal"
4. AFTA as much of an investment accord as a trade accord; followed by AIA and AFAS, which has a long way to go

Evolution of ASEAN Integration, continued

- ASEAN Economic Community (AEC):
 - 1. Proposed in Nov 2002; endorsed at Bali Summit in Oct 2003
 - 2. Reasons:
 - A. New, comprehensive post-AFTA agenda
 - B. Perceived need to deepen integration, given new regional zeitgeist and potential trade/investment diversion
 - C. Fear of diluting ASEAN cooperation due to bilateral FTAs of ASEAN partners

Evolution of ASEAN Integration, continued

- AEC Reasons, Continued
 - D. Lessons from Asian Crisis regarding need to link financial/monetary and trade integration
 - E. Perceived success in EU, both in terms of SEA and implementation of euro

III. Lessons from the EU

- I. Caveats in Making Comparisons:
 - 1. Institutional Environment facing ASEAN in 2000s different than EEC in 1950s:
 - a. "European Good" after war, forcing cooperation beyond economic institutions
 - b. Security considerations
 - c. Easier to create supranational institutions in that environment, relative to ASEAN
 - d. Moreover, European supranational institution building has mixed record and is EXPENSIVE



Lessons from the EU, continued

- 2. *International* environment is very different today
 - A. International marketplace is far more open; cost of inward-looking policies, like those of early EEC, higher.
 - I. Puts constraints (luckily!) on compromises like CAP.
 - II. "Tariff Hoping" FDI gives way to "Competitive FDI"
 - B. New Regionalism poses new challenges to ASEAN that the EEC never had to face; ASEAN cannot look inward as it relies far more on non-ASEAN markets. Must be far more concerned about trade/investment diversion due to regionalism elsewhere



Lessons from the EU, continued

- 3. ASEAN faces far greater diversity
 - A. Coefficient of variation on ASEAN per capita GDP: 1.62 (2004), among highest in world. EU=0.6 (before 2004 expansion)
 - B. Greater diversity in terms of economic policy (as well as other social aspects of cooperation)
 - C. Makes deeper integration more difficult
 - D. Complicates speed of implementation of integration
 - E. 10-X?



Lessons from the EU, continued

- II. Specific Lessons:
 - 1. AEC needs to embrace an outward-oriented approach to integration
 - A. Inward policies didn't work even in EEC context, though this could be debated
 - B. They would be disastrous for ASEAN, which is more open and trades more with non-partners
 - C. ASEAN is relatively poor and cannot afford it anyway



Lessons from the EU, continued

- 2. The EU experience testifies to importance of trade and investment links
 - A. Integration didn't really take off until SEA, with FDI/capital-flow integration aspects
 - B. Structural transformation in ASEAN is being driven in large part by FDI (especially in its more important sector, electronics) and this puts a higher premium on need for recognition of such links
 - C. Empirical studies underscore importance of link



Lessons from the EU, continued

- 3. SEA was necessary to create a truly integrated market.
 - A. Customs union: necessary but not sufficient condition for market integration
 - B. Prior to SEA, EC market was segmenting even further
 - C. Non-border, facilitation, and "best-practices" aspects of SEA yielded greater gains (Cecchini Report 1986)
 - D. SEA affects trade, FDI and finance



Lessons from the EU, continued

- 4. Financial and monetary cooperation and integration need to be undertaken *in tandem* with real integration
 - A. Financial integration separate prior to SEA; very little progress in terms of integrating markets
 - B. Monetary cooperation (besides EPU) not so important in 1950s-1973, due to Bretton Woods. Still:
 - I. Werner Report (1968) due to internal problems in BW
 - II. Post BW cooperation not successful in 1970s, before EMS (1979). ECU was key to market integration
 - III. Single banking market only with SEA

Lessons from the EU, continued

Financial and monetary cooperation, continued

- IV. ECU bond market took off spontaneously after 1981
- V. Monetary union was really a long process; one has to start off slowly.
- VI. AEC does not have at present the same motivations for monetary union as the EU: While the economics are just as good, the politics are not there, though they are getting better in wake of Crisis
- VII. However, ASEAN has perhaps even a greater incentive to integrate capital markets, due to liquidity problems at national level and problems associated with one-pillar finance system (banking).

Lessons from the EU, continued

Financial and monetary cooperation, continued

- VIII. After Hanoi action plan and AEC, ASEAN has placed a priority on capital market integration
- IX. ASEAN Bond Market idea is being replaced by Asian Bond Market idea. First step: Asian bond pool
- X. Many institutional problems to overcome in order to achieve this. In some ways, EU not there yet.
- XI. European experience underscores importance of Common Currency Basket

Lessons from the EU, continued

- 5. Developing institutions are important:
 - A. But EU has arguably gone "overboard"; much critique of EU institutions; popular protest against them (e.g., referendum on EU Constitution).
 - B. Economic institutions were most important in EU; commercial policy was only integrated policy.
 - C. Even if it takes an *de minimus* approach, ASEAN has a long way to go in creating institutions to support the AEC.

IV. On Building the AEC

- 1. Great complications, given diversity of region and especially CLMV. NOT faced by EEC.
- 2. Diversity in tariff structure makes customs union tough; Singapore can't raise tariffs from zero; tough politically for others to embrace zero tariff CET
- 3. 10-X is always possible but suboptimal, given need to integrate markets

On Building the AEC, continued

- 4. CET:
 - A. Need it; 10-X only if X is transitioned in. EU experience show that gains limited otherwise
 - B. Setting at: 0-5% would be most effective.
 - C. Certainly, this will prevent ASEAN Members from using industrial policy through trade, but not particularly effective anyway; Transition period is long; exceptions can be made.

On Building the AEC, continued

- 4. Labor market integration also difficult; unskilled labor flows left out but skilled to be included. Makes sense; most important for FDI. Many challenges (e.g., mutual recognition of professional qualifications).
- 5. Free flow of capital: FDI, easy. Rest will take considerable effort, but there is political will (with safeguards?).
- 6. AEC must go much further in terms of services; difficult but could lead to significant gains. AFAS has not gone far.



On Building the AEC, continued

- 7. To complete AEC, ASEAN will ultimately also need other aspects of SEA, e.g., mutual recognition and such. Long, difficult process.
- 8. Institutional development, never an ASEAN strongpoint, will have to receive a high priority.



V. Concluding Remarks

- **1. The AEC has developed organically, in response to national, regional, and global influences. It is an ambitious project given the current state of integration.**
- **2. The EU experience holds myriad lessons for the AEC, both positive and negative.**



Concluding Remarks, continued

- 3. Depending on how it develops, the AEC could go a long way in creating a single market within ASEAN.
- 4. If outward-oriented (and we argue there could be no other option for ASEAN), the AEC could generate significant benefits to the region.
- 5. But the process will be complicated and it will take significant political will.