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Part 1 of 2: ASEAN: A single market and production base

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At their Bali Summit of October 2003, ASEAN Leaders declared the establishment of an ASEAN Economic Community (AEC) as one of the three pillars of a broader ASEAN Community. The other two pillars are ASEAN Security Community and ASEAN Socio-Cultural Community.

In particular, they declared AEC as the realization of the end-goal of economic integration as outlined in the ASEAN Vision 2020. It is characterized as a single market and production base, with free flow of goods, services, investment and skilled labor, and freer flow of capital by 2020.

ASEAN Leaders also declared the acceleration of regional integration in 11 priority sectors as recommended by a High Level Task Force (HLTF) on ASEAN Economic Integration.

At the ASEAN Economic Ministers (AEM) Retreat on April 21 in Singapore, the Ministers set 2010 as the ultimate deadline for economic integration in those sectors.

Towards that end, roadmaps are to be prepared by countries designated to coordinate accelerated integration in those sectors, as follows: Indonesia for Wood-Based Products and Automotives; Malaysia for Rubber-Based Products and Textiles and Apparels; Myanmar for Agro-Based Products and Fisheries; Philippines for Electronics; Singapore for Information and Communications Technology (e-ASEAN) and Health Care; and Thailand for Air Travel and Tourism.

These roadmaps are to be presented to the ASEAN Economic Ministers at their September 2004 meeting.

One useful way to facilitate understanding of the characterization of AEC as a single market and production base is to make a distinction between the product market and the factor market, and the nature of goods and services traded in those markets between buyers and sellers.

In the product market, goods and non-factor services, e.g. air transport service produced by Garuda International or insurance service produced by Manulife, are traded (sold or bought) between producers on the one hand and consumers and investors on the other. They are recorded as consumption or investment expenditure in the accounting of economic activities. If the seller and the buyer are from different countries, they are recorded as exports and imports.

As a single market, there would be no barrier, tariff or non-tariff, to the flow of these goods and services within the community and across the 10 countries. With full implementation of the Green Lane system for products covered by the ASEAN Free Trade

Agreement (AFTA), electronic processing of trade documents, harmonization of standards, implementation of Mutual Recognition Agreements, no visa entry and exit, and removal of all other non-tariff and technical barriers, there would be free movement of goods and people, e.g. Garuda staff, rendering non-factor services.

Take one of the 11 priority sectors as an example. By 2010, a car produced in the Eastern Seaboard of Thailand can be moved freely across the border and sold to Malaysian consumers in Penang almost as easy as moving and selling it to Thai consumers in Chiang Mai.

Likewise, by 2010, tires produced in Penang can be moved and sold to investors (car manufacturers) in the Eastern Seaboard of Thailand or to consumers (car owners) in Bangkok almost as easy as moving them to Kuala Lumpur.

In the factor market, labor and capital rather than goods and non-factor services are traded between producers (or users) and factor owners. As a single market, there would be a free flow of these factors of production within the community and across the 10 countries. With no visa entry and exit, a commercial bank in Jakarta, for instance, can hire an accountant (owner of skilled labor) from Manila almost as easily as from Bandung.

With free entry and exit of capital (often referred to as relaxation of the capital account) Singaporean owners of capital (capitalists?!) can buy stocks or bonds in Vietnam through their financial intermediaries almost as easy as buying them from the local stock exchange or bond market.

Entrepreneurs in search of opportunities for making profit can set up and do their business anywhere in the community where profit can be made most as if it is just one country.

ASEAN would thus become a community of 10 countries, functioning as a single market for goods, (non-factor) services and factors of production. The AEC can be seen from this perspective, which is from the demand side.

There is of course another perspective from the supply side. In order to supply goods and services, producers buy intermediate goods from others in the product market and primary production inputs from the factor market.

Taking the automotive sector once again as an example, a car manufacturing company that has chosen Thailand as a production base can import the tires produced in Malaysia and batteries produced in the Philippines, employ skilled labor from Vietnam, and borrow working capital from Singapore, depending on where those intermediate and primary inputs could be procured at least cost, taking account of transportation, communication and other transaction costs.

The latter refers to costs incurred to link and coordinate the sourcing of production inputs from different countries. Devoid of tariff, non-tariff and other technical barriers to the movement of goods and factors of production, those transaction costs would become minimal by 2010. By then, ASEAN composed of 10 countries would become a single production base.

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Part 2 of 2: ASEAN: A single market and production base

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Without doubt, the primary objective behind the decision to build a community functioning as a single market and production base is to enhance economic competitiveness of ASEAN producers, i.e. to be able to produce and sell in the domestic, regional and international market.

But beyond a highly competitive and therefore prosperous economic region, the leaders also envision it to be one in which there is equitable economic development and reduced poverty and socio-economic disparities by 2020.

Indeed, with increasing globalization of economic transactions, firms have to be internationally competitive even in their domestic market.

As goods and services flow freely in a single market of half a billion population, more opportunities for specialization in a particular sector or sub-sector would be created, based on the comparative advantages of the 10 member countries. Countries where power can be produced and distributed at a relatively lower cost could specialize in power intensive industries.

Other countries with abundant skilled labor could specialize in skilled labor intensive sectors. Production costs would also be lower because of economies of scale, thereby enhancing competitiveness. Entrepreneurs would be attracted to set up and do business in ASEAN as an alternative to China and other big single markets. They would also be encouraged to outsource their inputs from within the Community rather than from outside in the production supply chain.

There is, however, one big factor that would constrain any measure to transform ASEAN into a single market and production base: The development gap that currently exists between member countries.

The per capita gross domestic product (GDP) of the richest country is 14 times more than that of the poorest country, even when GDP is compared in terms of purchasing power parity. When market exchange rate is used, the disparity becomes much bigger.

ASEAN must therefore reduce this huge development divide so that member countries can move forward towards economic integration in a unified manner and the benefits of integration are equitably shared.

Another constraining factor would be the limited liberalization in the factor market. Closer examination of the HLTF Recommendation adopted by Bali Concord II would reveal that economic integration in the factor market even in the 11 priority sectors would remain restricted.

With respect to labor, free flow of skilled labor only is included in the characterization of the AEC, implying that movement of unskilled labor will continue to be restricted. In fact, not even movement of skilled labor is included in the main text of Bali Concord II, indicating an internal contradiction in the Declaration itself.

With respect to capital, only a freer flow is targeted by 2020 and presumably by 2010 in the 11 priority sectors identified for accelerated integration. This implies that capital entry and exit will continue to be restricted and regulated by then but will be "freer" relative to the situation in 2003.

These aspects of integration in the factor market would need to be operationally defined and agreed upon as soon as possible so that acceleration of economic integration in the 11 priority sectors would not be jeopardized. In particular, what would be an operational definition of a skilled labor, or a semi-skilled labor for that matter, that would be agreeable to the member countries? What exactly would be the limitations to the entry and exit of capital within ASEAN?

Subject to the constraints arising from the development divide and to restrictions in the flow of labor and capital, ASEAN leaders envision an economic community of 10 (or more?) nations functioning as a single market and production base by 2020, and by 2010 in the 11 priority sectors.

The premise is that economic integration would enhance economic efficiency and competitiveness, and thereby promote sustained economic growth, reduce poverty and economic disparities, and realize equitable and inclusive development of the countries comprising the community.

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