

Executive Summary Backgrounder

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Enabling ASEAN's Economic Vision

Walter Lohman and Anthony B. Kim

U.S. interests in Asia begin with a stable, secure geopolitical and economic order that is friendly to free commerce. Central to this is an Association of Southeast Asian Nations (ASEAN) that can confidently hold its own, particularly in the face of China's incredible economic growth and rise as a global power. ASEAN needs an integrated, liberal economy of scale to meet the challenge. The U.S. has a major interest in helping ASEAN to reach this goal.

ASEAN at 40 Years. At 40 years of age, ASEAN—which encompasses the five original member countries of Indonesia, Malaysia, the Philippines, Singapore, and Thailand and the newer member countries of Brunei, Cambodia, Laos, Burma, and Vietnam—is the oldest and largest organization of its kind in Asia. ASEAN countries have a combined population of more than 500 million people—larger than the population of the European Union. Their combined gross domestic product (GDP) exceeds \$1 trillion and is the 11th largest in the world, ahead of Russia and India.

ASEAN has committed itself to making the most of its collective economic strength by achieving an integrated, liberal market. Ten years ago in Kuala Lumpur, ASEAN launched ASEAN Vision 2020, which calls for creating “a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-

economic disparities.” This is ASEAN's guiding economic vision. It is echoed repeatedly in ASEAN documents, including the new ASEAN Charter.

Despite its pledges, however, economic integration is today more aspiration than reality. ASEAN is not a single integrated market. It is 10 separate markets that are no more economically integrated with each another than they are with economies outside of ASEAN. Intra-ASEAN trade accounts for only about 25 percent of its global trade. Intra-ASEAN foreign direct investment (FDI) amounts to 11 percent of total FDI into ASEAN.

However, the measure of ASEAN's economic integration is not only intraregional trade and investment flows, but also its attractiveness as an investment destination. Yet even as it has sought ever new ways to stay competitive as a region, ASEAN has lagged behind China—particularly since the 1997 Asian financial crisis. (A few years prior to the crisis, ASEAN actually led China as an investment destination.)

It has been famously said that what East Asian economic integration needs is management, not

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vision. While ASEAN's dizzying array of agreements, initiatives, and commitments clearly lacks adequate management, ASEAN's vision is also unresolved. The member countries' less-than-resolute commitment to free markets contributes directly to the management problem. It forces ASEAN to pursue a lowest-common-denominator path to integration that leaves it short of its ambitious economic goals. True commitment to economic freedom would ease integration by eliminating obstacles and feeding the market forces that are responsible for whatever real cross-border economic activity is taking place.

The ASEAN countries need to decide that ASEAN Vision 2020 is where they want to go, make the difficult choices at the national level that are required to achieve that vision, and exercise the necessary political will to follow through. With the right level of commitment, managing ASEAN economic integration will become easier, and an integrated, liberal Southeast Asian market will become a reality.

What the U.S. Should Do to Help. The United States should:

- **Stabilize** the American diplomatic commitment to ASEAN,
- **Intensify** U.S. Trade Representative involvement in the ASEAN economic ministers and associated forums,

- **Expand** the U.S.–ASEAN Trade and Investment Framework Arrangement (TIFA) work program to address non-tariff barriers, barriers in cross-border services trade, and investment issues,
- **Stay focused** on an eventual U.S.–ASEAN free trade agreement (FTA),
- **Continue** to look for bilateral FTA opportunities, and
- **Fully fund** the ASEAN Development Vision to Advance National Cooperation and Economic Integration (ADVANCE).

Conclusion. ASEAN's ambition is clear, its record in implementing agreements to facilitate economic integration is spotty, and its commitment to economic freedom is subpar. ASEAN requires a resolution of vision to get to ASEAN Economic Community. It also needs the tools and resources to manage the undertaking effectively.

The U.S. cannot give ASEAN the political will that it needs, but by demonstrating serious, sustained interest in ASEAN's economic life, the U.S. can ensure that its advice and concerns are taken into account. The U.S. can also engage at the technical level in a way that enables the group to meet its objectives.

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Background

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At 40 years of age, the Association of Southeast Asian Nation (ASEAN)—which encompasses the five original member countries of Indonesia, Malaysia, the Philippines, Singapore, and Thailand and the newer member countries of Brunei, Cambodia, Laos, Burma, and Vietnam—is the oldest and largest organization of its kind in Asia. ASEAN countries have a combined population of more than 500 million people—larger than the population of the European Union. Their combined gross domestic product (GDP) exceeds \$1 trillion, which is the 11th largest in the world, ahead of Russia and India.¹

ASEAN has committed itself to making the most of its collective strength by achieving an integrated, liberal market. Ten years ago in Kuala Lumpur, ASEAN launched ASEAN Vision 2020, which calls for creating “a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities.”² This is ASEAN's guiding economic vision. It is echoed throughout ASEAN documents, including the new ASEAN Charter.

Despite its pledges, however, economic integration remains more aspiration than reality. Today, ASEAN is not a single integrated market. It is 10 separate markets that are no more economically integrated with each another than they are with economies outside of ASEAN. Intra-ASEAN trade accounts for only about 25 percent of its global trade.³ Intra-ASEAN foreign

Talking Points

- An ASEAN that can confidently hold its own in the face of China's incredible economic growth and rise as a global power is central to American interests.
- The U.S. should stabilize the American diplomatic commitment to ASEAN with consistent heads-of-state level diplomacy and reliable Cabinet-level participation in the ASEAN Regional Forum.
- USTR should intensify its dialogue with the ASEAN economic ministers and expand the Trade and Investment Framework Arrangement work program to address non-tariff barriers, barriers in cross border services trade, and investment issues.
- The U.S. should advance stalled FTAs with Malaysia and Thailand and lay the groundwork for other FTAs in the region with an eye to eventual conclusion of a U.S.-ASEAN FTA.
- The U.S. should fully fund the ASEAN Development Vision to Advance National Cooperation and Economic Integration (ADVANCE), a five-year, \$150 million project to strengthen ASEAN.

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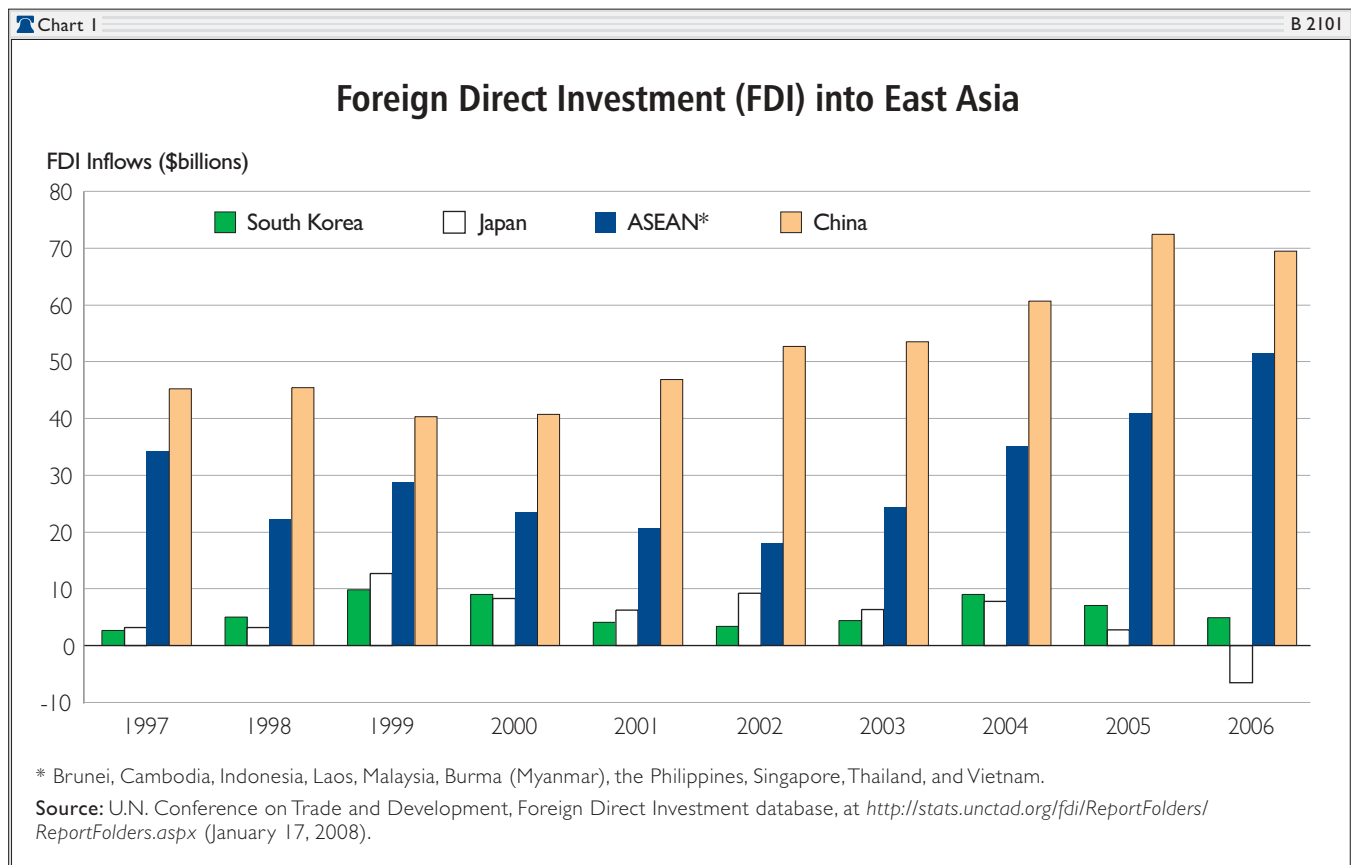
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direct investment (FDI) amounts to 11 percent of total FDI into ASEAN.⁴

Even these figures give an inflated picture of the current state of economic integration, because not all ASEAN countries contribute equally. For instance, Singapore, which has a world-class economy, contributes far more to intraregional trade and investment than less-developed Laos contributes.

The measure of ASEAN's integration is not only intraregional trade and investment flows, but also

its attractiveness as an investment destination. From the 1992 launch of the ASEAN Free Trade Area (AFTA) to the signing of its Economic Community Blueprint in November 2007, achieving economy of scale in ASEAN has always meant attracting greater levels of foreign investment. Yet even as it has sought ever new ways to stay competitive as a region, it has lagged behind market-leader China—particularly since the 1997 Asian financial crisis. (A few years prior to the crisis, ASEAN actually led China as an investment destination.)



1. World Bank, "Total GDP 2006," World Development Indicators database, July 1, 2007, at <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf> (January 18, 2008).
2. Association of Southeast Asian Nations Secretariat, "ASEAN Vision 2020," December 15, 1997, at www.aseansec.org/2357.htm (December 4, 2007).
3. Michael G. Plummer, "The ASEAN Economic Community and the European Experience," Asian Development Bank, Office of Regional Economic Integration Working Paper on Regional Economic Integration No. 1, July 2006, at <http://aric.adb.org/pdf/workingpaper/WP1%20Plummer%20230706.pdf> (December 3, 2007). By contrast, intra-EU trade accounts for 66 percent of the EU's global trade.
4. Michael G. Plummer and David Cheong, "FDI Effects of ASEAN Integration," paper for "Is Free Trade Still Relevant in the 21st Century?" conference at International Business School, Brandeis University, June 15, 2007, at http://people.brandeis.edu/~crown/conferences/mcculloch/Plummer_Cheong.pdf (December 3, 2007).

It has been famously said that what East Asian economic integration needs now is management, not vision.⁵ While ASEAN's dizzying array of agreements, initiatives, and commitments clearly lacks adequate management, ASEAN's vision is also unresolved. The member countries' less-than-resolute commitment to free markets contributes directly to the management problem. It forces ASEAN to pursue a lowest-common-denominator path to integration that leaves it short of its ambitious economic goals. True commitment to economic freedom would ease integration by eliminating obstacles and feeding the market forces that are responsible for whatever real cross-border economic activity is taking place.

The ASEAN countries need to decide that ASEAN Vision 2020 is where they want to go, make the difficult choices at the national level that are required to achieve that vision, and exercise the necessary political will to follow through. With the right level of commitment, managing ASEAN economic integration will become easier, and an integrated, liberal East Asian market will become a reality.

Managing ASEAN Economic Integration

ASEAN's integration machinery is unique. Each year, official summits produce new initiatives aimed at furthering economic integration. Some initiatives are cursory and self-executing. Many are detailed and aimed at fulfilling previous commitments. Taken together, the scale of the planned restructuring of the regional economy is extraordinary, and the task of managing it is massive.

To ease implementation and provide a rationale commensurate with its challenges, in 2003, ASEAN

brought all of these efforts under the one conceptual roof of ASEAN Economic Community.

ASEAN Economic Community. ASEAN has identified its effort to establish "a single market and production base" through the "free flow of goods, services, investment and a free flow of capital"⁶ with the explicit goal of achieving an "economic community."

It has since accelerated the timetable for completion from 2020 to 2015 and developed detailed implementation plans. The ASEAN Economic Community (AEC) is intended to strengthen existing agreements—principally the ASEAN Free Trade Area, the ASEAN Investment Area, and the ASEAN Framework on Services—and to accelerate integration in priority sectors.⁷ ASEAN's progress in managing ASEAN economic integration must begin with an assessment of these agreements and their economic impact.

ASEAN Free Trade Area. By far ASEAN's most successful effort toward building a competitive economy of scale has been the ASEAN Free Trade Area (AFTA). AFTA was signed in 1992 and is largely on track. The ASEAN-6 include ASEAN's major national economies—Indonesia, Malaysia, the Philippines, Singapore, and Thailand—as well as Brunei.

The ASEAN-6 have reduced tariffs to from 0 percent–5 percent on nearly 99 percent of the products covered under AFTA and are moving toward full tariff elimination by 2010. As of August 2007, the ASEAN-6 had *eliminated* tariffs on more than 70 percent of the products covered by the AFTA.⁸ (For these economies, almost all of their trade in goods is covered.)⁹ The lesser developed ASEAN countries are on a slower schedule but are also making respectable

5. Richard E. Baldwin, "Managing the Noodle Bowl: The Fragility of East Asian Regionalism," Graduate Institute of International Studies, Geneva, January 2006.

6. Association of Southeast Asian Nations Secretariat, "Declaration of ASEAN Concord II (Bali Concord II)," October 7, 2003, at www.aseansec.org/15159.htm (December 5, 2007).

7. *Ibid.* The priority sectors are agro-based products, automotives, e-ASEAN, electronics, fisheries, health care, textiles and apparel, wood-based products, rubber-based products, tourism, air travel, and logistics.

8. Association of Southeast Asian Nations Secretariat, "Joint Media Statement," August 23, 2007, at www.aseansec.org/20857.htm (December 3, 2007).

9. Ludo Cuyvers, Philippe DeLombaerde, and Stijn Verherstraeten, "From AFTA Towards an ASEAN Economic Community... and Beyond," Center for ASEAN Studies, January 2005.

progress. Laos and Burma must reduce tariffs to the 0 percent–5 percent range by 2008, and Cambodia must do so by 2010. They and Vietnam are then obliged to eliminate tariffs completely by 2015.¹⁰

Coverage and compliance are good. However, when it comes to actual trade, AFTA is not fully utilized for a number of reasons. Its broad benefits are brought to bear on only 5 percent of intra-ASEAN trade. So while ASEAN can claim double-digit growth in intra-ASEAN trade,¹¹ it cannot claim that the increases are driven by AFTA. In fact, even without applying AFTA, the amount of trade among ASEAN countries is rising no faster than ASEAN's trade with the rest of the world.¹²

Underutilization of AFTA points to several key problems. The application procedure for AFTA is unclear and not well publicized. More important, the marginal savings over the standard most-favored-nation rate is often not sufficiently greater than the processing cost. It is simply not worth the trouble to apply.

This points to a fundamental problem: ASEAN's low-ball definition of free trade and slow schedule for tariff elimination. ASEAN's interim tariff level of 5 percent is above the tariff rates to which industrialized countries are committed under the Uruguay Round.¹³ Where the tariff reductions under AFTA are significant, non-tariff barriers (NTBs) often remain. This makes NTBs a major obstacle on ASEAN's road to economic integration. The organization's efforts to remove them have been largely ineffectual.¹⁴

Finally, a clear, trusted, effective mechanism for addressing non-compliance is a necessary part of any trade agreement. ASEAN has a dispute settlement mechanism with application to AFTA commitments, but it has never been used.

ASEAN Framework Agreement on Services.

In 1995, ASEAN launched the ASEAN Framework Agreement on Services (AFAS) to “eliminate substantially restrictions to trade in services” by going beyond General Agreement on Trade in Services (GATS) commitments to achieve a “free trade area in services.”¹⁵ There have been six packages of commitments under the AFAS. To ease implementation, ASEAN has employed its ASEAN-X mechanism, which means that countries ready to move forward with new commitments may do so without the immediate participation of all ASEAN members.

AFAS implementation has been slow and uneven. On balance, more than 10 years since the agreement was signed in Bangkok, “member countries’ commitments have not been significantly bolder and more far-reaching” than their commitments to liberalize under GATS.¹⁶ While intra-ASEAN barriers to trade in services have fallen for every ASEAN country and are now 10 percent lower for intra-ASEAN trade than for countries outside ASEAN, Singapore and Malaysia, the two biggest providers of services in ASEAN, provide no substantial benefit to their ASEAN neighbors above their global GATS commitments.¹⁷

10. Association of Southeast Asian Nations Secretariat, “ASEAN Economic Community Blueprint,” November 20, 2007, at www.13thaseansummit.org.sg/asean/index.php/web/content/download/819/6832/version/1/file/AEC.pdf (January 17, 2008). There are exceptions and “flexibilities” for sensitive products.
11. Association of Southeast Asian Nations Secretariat, *ASEAN Statistical Yearbook 2006*, p. 61, at www.aseansec.org/13100.htm (December 28, 2007).
12. Denis Hew, ed., *Brick by Brick: The Building of an ASEAN Economic Community* (Singapore: Institute of Southeast Asian Studies, 2007), p. 211.
13. John Ravenhill, “Fighting Irrelevance: An Economic Community ‘with ASEAN Characteristics,’” Australian National University, Department of International Relations Working Paper No. 2007/3, July 2007, at http://rspas.anu.edu.au/ir/pubs/work_papers/07-3.pdf (December 12, 2007).
14. Loreli C. de Dios, “Non-Tariff Barriers to Trade in the ASEAN Priority Goods Sectors,” in Hew, ed., *Brick by Brick*, pp. 101–102.
15. Association of Southeast Asian Nations Secretariat, “ASEAN Framework Agreement on Services,” December 15, 1995, at www.aseansec.org/6628.htm (December 11, 2007).
16. Hew, ed., *Brick by Brick*, p. 211.

Beyond this structural problem, AFAS has been hampered by the poor quality of regulations, lack of proper governance, and unpredictability.¹⁸ Transparency requires more than posting commitments on ASEAN's Web site, which it does to its credit. It means that commitments should not be subject to ongoing, unpredictable modification and that information on new policies, laws, and regulations should be made generally available for comment before they are enforced.¹⁹ ASEAN is not meeting this standard.

The ASEAN Investment Area. In 1995, ASEAN endorsed investment liberalization as a basis for enhancing its collective "attractiveness and competitiveness" for investment. In 1998, it followed through on this mandate by creating the ASEAN Investment Area (AIA).²⁰ The AIA declared an "immediate opening up of all industries for investment, with some exceptions...to ASEAN investors by 2010 and to all investors by 2020." It also declared "immediate national treatment" on the same schedule.²¹

The agreement is in effect more modest. It covers five economic sectors—manufacturing, agriculture, fisheries, mining, and quarrying—and services incidental to these sectors. This excludes two-thirds of the most attractive areas for FDI from the outset.²²

Still, the AIA is an important part of realizing ASEAN's economic vision. The devil is in the exceptions. The member countries drew up the lists of exceptions, some of which were to be phased out. For instance, Brunei, Indonesia, Malaysia, Myanmar (Burma), the Philippines, Singapore, and Thailand had until January 1, 2003, to phase out their excep-

tions for manufacturing. As of 2006, three continuing exceptions remained on that list. Cambodia, Laos, and Vietnam have until 2010 to phase out their 28 exceptions for manufacturing.

Exceptions in "sensitive areas" are not required to be phased out but are to be reviewed and phased out if and when the governments are ready. As of 2006, the list of such sensitive sectors contained 148 measures in manufacturing.²³

Over and above both of these categories, there is the General Exception List, which covers "industries and investment measures that cannot be opened up for investment or granted national treatment because of reasons of national security, public morals, public health or environmental protection."²⁴ For these sectors, not only is there no requirement that they ultimately be phased in, but there is no requirement that they be *considered* for inclusion in the AIA.

In 2004, a report by the well-respected Thailand Development Research Institute shed some light on how an agreement intended to open up intra-regional investment has managed to fall so far short:

[S]ome member countries list all manufacturing industries in the negative list... Other member countries, including Thailand, simply reproduce the list of restrictions under current laws or regulations and compile them into the sensitive list, which require occasional review but no phasing-out commitments.²⁵

On the positive side, across the industries covered by the AIA, 14 exceptions on the original lists

17. Do Vo Tri Thanh and Paul Bartlett, "Ten Years of ASEAN Framework Agreement on Services (AFAS): An Assessment," Regional Economic Policy Support Facility, Project No. 06/004, July 2006, at www.aadcp-repsf.org/docs/05-004-FinalReport.pdf (January 4, 2008), p. 34.

18. *Ibid.*

19. *Ibid.*

20. Association of Southeast Asian Nations Secretariat, "Framework Agreement on the ASEAN Investment Area," October 7, 1998, at www.aseansec.org/6466.htm (December 7, 2007).

21. Association of Southeast Asian Nations Secretariat, "ASEAN Investment Area: An Update," at www.aseansec.org/8024.htm (December 4, 2007) (emphasis added).

22. Plummer and Cheong, "FDI Effects of ASEAN Integration." Information available upon request from the authors.

23. *Ibid.* Information available upon request from the authors.

24. Association of Southeast Asian Nations Secretariat, "ASEAN Investment Area."

have been phased out, while another 51 have been transferred from the sensitive list to the phase-in list. However, if the purpose of the AIA is to create an open investment environment across ASEAN, the limited coverage, exceptions, and progress to date are major problems. As a result, after 10 years, the agreement “has not had a discernable effect on FDI inflows.”²⁶

Fast-Tracked Priority Sectors. In 2004, ASEAN singled out 11—later expanded to 12—sectors for integration.²⁷ They were fast-tracked in the context of full economic integration by 2015. The priority sectors are agro-based products, automotives, e-ASEAN, electronics, fisheries, health care, textiles and apparel, wood-based products, rubber-based products, tourism, air travel, and logistics. In 2004, these sectors accounted for more than 50 percent of intra-ASEAN trade. The ASEAN-6 (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) were to eliminate all import duties in these areas by 2007, and the other ASEAN members were to eliminate them by 2012. This constituted an acceleration of their AFTA commitments by three years. Beyond tariffs, a number of other impediments to trade were targeted for elimination including NTBs associated with product standards and regulations, testing certification, investment facilitation, and overlapping authorities at the products’ points of entry.²⁸

Progress in meeting these commitments has been broadly characterized as “far from complete and

generally slower than anticipated.”²⁹ One detailed study criticized compliance in removing NTBs in these sectors as follows: “[NTBs] continue to exist in all priority sectors in all ten countries, and there is no evidence that their height or incidence has declined.”³⁰ The same study characterized liberalization in the priority service sectors as “extremely low” and the NTBs as “sizable.”

ASEAN Economic Community Blueprint. On November 20, 2007, ASEAN leaders signed the Declaration on the ASEAN Economic Community Blueprint. Conceptually, the blueprint brings the constituent parts of the AEC, which includes the above-referenced agreements and other commitments, together with measures to deepen integration. It also features a master implementation plan. The blueprint is an admirable effort to compile and organize the AEC task list.

Among its positive details, the blueprint provides for a review of both the ASEAN Investment Area and a long-standing agreement that specifically provides investment protection.³¹ It aims to bring the two together in a new stronger, inclusive agreement called the ASEAN Comprehensive Investment Agreement. The blueprint places renewed focus on completely removing NTBs. It also initiates a regional discussion on competition policy—something that most ASEAN members lack.³²

These are excellent initiatives. ASEAN’s commitment to its objectives is an encouraging demonstration that it recognizes its shortcomings. Better

25. Deuden Nikomborirak, “An Assessment of the Investment Regime: Thailand Country Report,” International Institute for Sustainable Development, March 31, 2004, p. 11, at www.iisd.org/pdf/2004/investment_country_report_thailand.pdf (December 12, 2007).

26. Plummer and Cheong, “FDI Effects of ASEAN Integration.” Information available upon request from the authors.

27. Association of Southeast Asian Nations Secretariat, “ASEAN Framework Agreement for the Integration of Priority Sectors,” November 29, 2004, at www.aseansec.org/16659.htm (December 26, 2007).

28. Media release, “ASEAN Accelerates Integration of Priority Sectors,” Association of Southeast Asian Nations Secretariat, November 29, 2004, at www.aseansec.org/16621.htm (December 12, 2007).

29. Ravenhill, “Fighting Irrelevance.”

30. Christopher Findlay, “An Investigation into the Measures Affecting the Integration of ASEAN’s Priority Sectors (Phase 2),” Regional Economic Policy Support Facility, Project No. 06/001a, April 2007, at www.aadcp-repsf.org/publications.html (January 17, 2008).

31. Association of Southeast Asian Nations Secretariat, “Agreement for the Promotion and Protection of Investment,” December 15, 1987, at www.aseansec.org/12812.htm (January 17, 2008).

32. Association of Southeast Asian Nations Secretariat, “ASEAN Economic Blueprint.”

organizing them is some indication that it takes its commitments seriously. Yet until it actually implements these commitments, the blueprint is just another ASEAN document. The AEC's 2015 deadline offers a bright benchmark against which progress can be measured.

The ASEAN Charter. ASEAN leaders well know that a blueprint alone will not lead to economic integration and the economy of scale that they need to stay competitive. ASEAN needs to find a “new ASEAN way”³³ that is rule-based and governed by stronger institutions. Hadi Soesastro, executive director of the Centre for Strategic and International Studies in Indonesia, has noted:

There is no point in pursuing an advanced and demanding notion as an AEC without deeper and testable commitment of the Member States and stronger institutions or a detailed treaty from the outset. Without endowed ASEAN institutions, without a treaty, without transfer of powers, and without any budget, one should not expect a credible ASEAN Economic Community to emerge.³⁴

Hence, in 2005, ASEAN agreed to establish an organizational charter—something ASEAN had been without since it was founded in 1967. An Eminent Persons Group (EPG) was established with a mandate to make recommendations for the charter. The recommendations were made on schedule, and a charter was drafted and approved on schedule on November 20, 2007, in Singapore.

The Singapore summit was overshadowed in the international press by concern about repression in Burma and ASEAN's failure to address effectively what even its own members termed revolting³⁵

behavior by one of its member countries. Accordingly, criticism of the charter focused largely on ASEAN's impotence in dealing with repression in Burma and the irony that the historic charter required the signature of the miscreant regime.³⁶

The focus on Burma was fair. The violent crackdown on pro-democracy demonstrators in September 2007 and the manner in which the ASEAN heads of state handled it two months later cast doubt on ASEAN's commitment to its own principles at the very time when it was enshrining those principles in the charter. One of the charter's purposes is “to strengthen democracy, to enhance good governance and the rule of law, and to promote and protect human rights and fundamental freedoms.”³⁷ ASEAN's failure to deal effectively with such a glaring breach of its principles as the September events in Burma raises serious doubts about whether or not the ASEAN Charter can provide the basis for forging a regional community.

If ASEAN finds a way to address this concern, the charter does contain some of the seeds for an effective institution. ASEAN largely adopted the EPG's recommendations. The charter creates a streamlined structure that makes inherent good sense and should help ASEAN to monitor and implement its various plans and road maps. More frequent meetings of its leaders should help ASEAN to shoulder more responsibility for outcomes and process. The creation of a formal appeal process for non-compliance with agreements, enshrining the principle of ASEAN-X, and endorsement of dispute settlement and arbitration are all very positive signs.

On the downside, the charter does not allow appeal to majority vote as recommended by the EPG. Instead, the charter reinforces the principle of

33. Hadi Soesastro, “Accelerating ASEAN Economic Integration: Moving Beyond AFTA,” Centre for Strategic and International Studies (Jakarta, Indonesia) *Economics Working Paper*, March 2005, at www.csis.or.id/working_paper_file/52/wpe091.pdf (December 27, 2007).

34. *Ibid.*

35. George Yeo, ASEAN Chair and Singapore Minister for Foreign Affairs, statement, September 27, 2007, at www.aseansec.org/20974.htm (January 4, 2008).

36. “Fifth from the Right Is the Party-Pooper,” *The Economist*, November 24, 2007.

37. “Charter of the Association of Southeast Asian Nations,” November 20, 2007, at www.aseansec.org/ASEAN-Charter.pdf (January 17, 2008).

“consultation and consensus” in ASEAN decision making, which has historically prevented it from making the tough decisions. Disputes that cannot be worked out using current procedures can be referred to the ASEAN heads of state. However, referral to the heads-of-state level will likely be seen as a “nuclear option.” There is the distinct risk that decisions will remain unresolved indefinitely out of respect for the offending parties’ sensibilities and that the dispute settlement process will go unused. In the event that a decision does reach the heads of state, they will be sorely tempted to avoid an embarrassing confrontation by delegating the decision back down to a lower level without making a final determination.

The EPG also recommended enforcement mechanisms and penalties including “suspension of rights and privileges,” but not expulsion. However, the current charter does not include these. As regards ASEAN’s finances, the EPG recommended—and ASEAN accepted—continued application of “equal contribution” to the ASEAN budget. This means that the poorest and the richest make the same level of financial contribution, effectively capping contributions at the lowest level and handicapping an organization that is already woefully short of needed resources.³⁸

At this point, the charter appears to lack at least two of the four criteria that Dr. Soesastro laid out in 2005: It does not provide for an adequate budget, and it does not transfer enforcement power. The charter is a living document, open to review and amendment. Time and the ratification process will tell whether the ASEAN Charter marks a watershed in ASEAN’s history or is just another document that bestows legal personality on ASEAN and makes ASEAN a more efficient structure but does little else.

Ultimately, even with the charter, economic integration comes down to political will. Without the political will, ASEAN economic integration will not occur.

Economic Freedom in ASEAN

ASEAN may not have achieved the basis for effective management of its economic commitments, yet that is only half of the battle. Any review of ASEAN’s ground-level economic environment points to the continuing need for vision.

Enhancing economic freedom is crucial to economic development and sustained prosperity in today’s increasingly integrated global market. Economic growth and prosperity depend on maintaining and improving an environment in which entrepreneurial activities and innovation can flourish. Economies with higher degrees of openness and flexibility benefit from the free exchange of commerce and thereby enjoy sustainable economic growth and prosperity.

The *Index of Economic Freedom*, published by The Heritage Foundation and *The Wall Street Journal*, systematically and empirically documents this relationship by evaluating countries’ economic freedom based on such things as ease of doing business, tariff and non-tariff barriers, property rights, corruption, and investment regimes. Each year, it uses data from internationally authoritative sources—the International Monetary Fund, World Bank, World Trade Organization, Transparency International, and others—to calculate a economic freedom rating for each country.

The *Index* paints a disparate, disappointing picture of ASEAN’s economy. Each ASEAN country’s overall score and scores for each of the 10 economic freedoms are presented in Table 1. The scores range from 0 (completely repressed) to 100 (completely free).

Chart 2 compares the simple average economic freedom score of ASEAN over the past decade with the averages for the Asia–Pacific region and the world. ASEAN’s economic freedom score has been stagnant and below both the world average and the Asia–Pacific average. ASEAN’s 2008 average economic freedom score is 57.9, which is below both the world

38. “The [European] Community administrative apparatus is beyond comparison with that of ASEAN (21,000 European officials as opposed to 177 in ASEAN, of whom 135 are recruited locally and only 42 due to their professional capacity.” Laurence Henry, “The ASEAN Way and Community Integration: Two Different Models of Regionalism,” *European Law Journal*, Vol. 13, No. 6 (November 2007), p. 862.

Table 1

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Economic Freedom in ASEAN

Country	Overall Score	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
Singapore	87.4	97.8	90.0	90.3	93.9	88.9	80	50	90	94	99.0
Malaysia	64.5	69.0	76.2	82.2	80.8	78.6	40	40	50	50	78.7
Thailand	63.5	72.1	75.2	74.7	90.7	66.7	30	50	50	36	89.6
Philippines	56.9	53.0	78.8	75.8	90.2	73.8	30	50	30	25	61.9
Cambodia	56.2	43.0	52.2	91.4	94.2	80.9	50	50	30	21	49.1
Indonesia	53.9	48.8	73.0	77.5	89.7	68.2	30	40	30	24	57.5
Vietnam	49.8	60.0	62.8	74.3	78.0	67.4	30	30	10	26	59.5
Laos	49.2	60.8	57.0	71.0	92.1	73.0	30	20	10	26	52.3
Burma	39.5	20.0	71.0	81.7	97.0	56.5	10	10	10	19	20.0
Brunei	—	—	—	—	—	—	—	—	—	—	—
ASEAN Average*	57.9	58.3	70.7	79.9	89.6	72.7	36.7	37.8	34.4	35.7	63.1
World Average*	60.3	62.8	72.0	74.9	67.7	74.4	50.3	51.7	45.6	41.1	62.1

* The ASEAN and world averages are averages of the countries' economic freedom scores. Brunei is excluded from the calculation of the ASEAN average.

Source: Kim R. Holmes, Edwin J. Feulner, and Mary Anastasia O'Grady, *2008 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2008), at www.heritage.org/index.

average score of 60.3 and the Asia-Pacific score of 58.7.

ASEAN performs considerably better than the world average only in fiscal freedom and government size. (See Chart 3.) The high scores in these two freedoms reflect that the ASEAN governments have more fiscal policy options at their disposal. However, ASEAN's overall economic freedom is severely hampered by lack of other freedoms, particularly business freedom, investment freedom, financial freedom, freedom from corruption, and property rights.

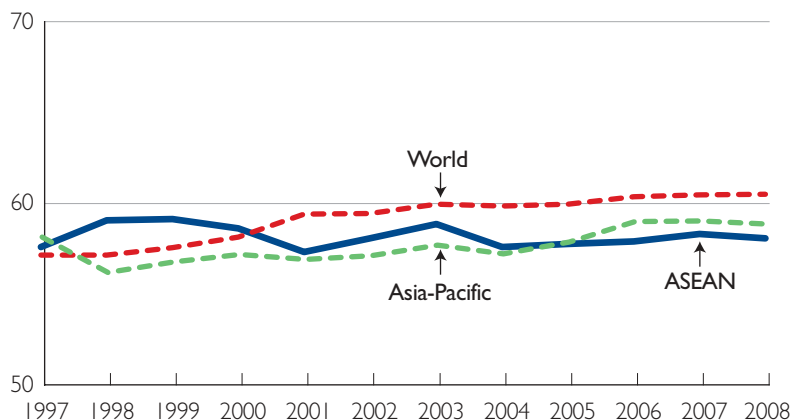
Business Freedom. ASEAN's business freedom score is 58.3, or 4.5 percentage points below the world average of 62.8 percent. Business freedom is a measure of how free entrepreneurs are to start businesses, how easily they can obtain licenses, and how easily they can close a business.

Chart 2

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Stagnant Economic Freedom in ASEAN

Economic Freedom Score



Note: The scores for ASEAN, Asia, and the world are the averages of the countries' economic freedom scores. Brunei is excluded from the calculation of the ASEAN score.

Source: Kim R. Holmes, Edwin J. Feulner, and Mary Anastasia O'Grady, *2008 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2008), at www.heritage.org/index.

Impediments to any of these three components deter business activity and, therefore, job creation.

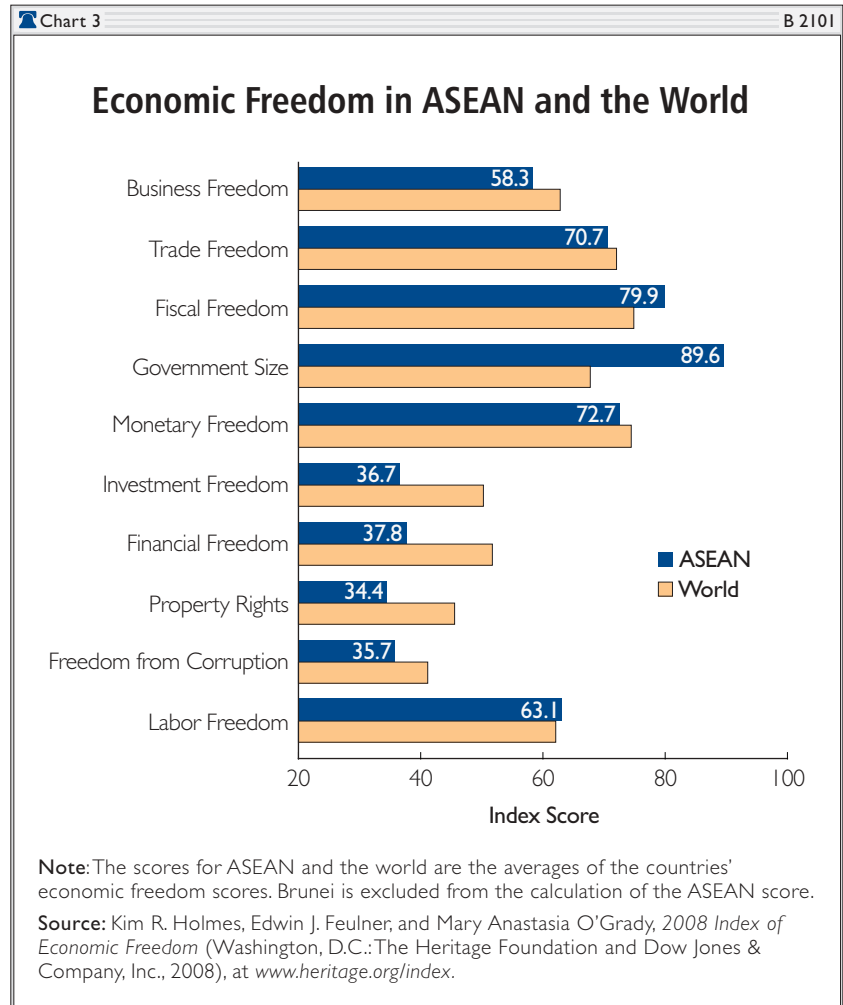
Trade Freedom. ASEAN's trade freedom score is 70.7, lower than the world average score of 72. ASEAN's total trade with the world is more than \$900 billion. Its weighted average tariff rate is around 7.2 percent, which is lower than the global average, but non-tariff barriers such as quotas, burdensome regulations and standards, and bureaucratic delays still significantly impede open commerce.

Fiscal Freedom. ASEAN's fiscal freedom score is 79.9, which is 5 points higher than the global average score of 74.9. The top tax rate on individual income averages around 32 percent, and the top tax rate on corporate income averages around 28 percent.

Government Size. ASEAN's score on government size, which measures government spending as a percentage of GDP, is 89.6. This is considerably higher than the global average score of 67.7. However, this high score does not mean that the ASEAN economies enjoy less government intervention. Government intervention in the economy is also reflected in investment and financial freedom scores and in other freedom scores.

Monetary Freedom. ASEAN enjoys a high level of monetary stability with a monetary freedom score of 72.7, which is slightly lower than the global average. The ASEAN economies' inflation rates have been moderate despite recent inflationary pressures from China. However, many ASEAN member economies maintain price controls on certain commodities through government intervention.

Investment Freedom. Capital flows are still severely restricted in ASEAN. ASEAN's average financial freedom score is 36.7, which is 13 points lower than the global average. Only Singapore, with a score of 80, enjoys high investment freedom. Most



ASEAN countries are significantly deficient in investment freedom, with scores of less than 50, which means that their overall investment climates are dampened by government restrictions.

Financial Freedom. Openness of ASEAN's banking and financial system scores 37.8. Many financial institutions are still controlled by the governments despite measures to strengthen legal systems, promote more transparent regulatory systems, and improve effective governance in capital markets. Burdensome and inconsistent banking regulations also reduce opportunities and restrict financial freedom.

Property Rights. Strengthening property rights is still a work in progress. ASEAN scores lowest in property rights with a score of 34.4. This is more than 10 percentage points lower than the world average. Although Singapore strongly protects

property rights, earning a score of 90, most ASEAN countries score less than 50.

Freedom from Corruption. ASEAN's score of 35.7 on freedom from corruption indicates that many ASEAN economies still suffer from persistent and systematic corruption. Regrettably, they have shown little progress. Singapore scores over 90, Malaysia scores 50, and the others have scores below 40. Freedom from corruption is ASEAN's second-lowest score among the 10 factors.

Labor Freedom. ASEAN enjoys a relatively high level of labor freedom of 63.1 percent, reflecting fewer restrictions on wages, hours, and hiring and firing workers. The world average score for labor freedom is 62.1.

Integrating Vision and Management

The record shows a few things very clearly. *First*, ASEAN is lagging in its effort to create an economic community. Without fundamental changes, it will likely not reach its goals by 2015. *Second*, to the extent that the economies have benefited from cross-border economic activity, it has been driven by market forces. No evidence suggests that the official ASEAN processes are significantly driving economic integration. *Third*, ASEAN as a whole has a long way to go on its road to economic freedom.

The management task of achieving an ASEAN Economic Community by 2015 is massive. However, the lack of resolve in ASEAN's vision is greatly complicating matters. The lack of progress in ASEAN's landmark economic agreements is a symptom of a bigger problem, and the ratings in the *Index of Economic Freedom* identify the causes. Governments, sectors, and businesses acting in their most narrowly defined interests have hampered ASEAN's development and pose the greatest threats to realizing an ASEAN Economic Community.

Better management and more resources are needed, but only a resolution of vision will lead ASEAN to its goals. In turn, commitment to reform at the country level will make the management task easier. When fewer areas of non-compliance need to be addressed, the exceptions list goes away, transparency is improved, and tariffs and NTBs are removed, fewer things will need to be managed. Managing commitments when they are being energetically met

is much easier than uncovering non-compliance and enforcing or cajoling compliance. Addressing issues of economic freedom will enable market forces to work effectively and to support compliance with agreements intended to unleash them.

Why ASEAN's Economic Integration Matters to America

U.S. interests in Asia begin with a stable, secure geopolitical and economic order that is friendly to free commerce. Central to this is an ASEAN that can confidently hold its own, particularly in the face of China's incredible economic growth and rise as a global power. ASEAN needs an integrated, liberal economy of scale to meet the challenge.

Without energetic American engagement with ASEAN's integration effort, there are two possible scenarios.

Scenario #1: ASEAN integration is achieved but remains essentially incomplete and becomes a cover for closer political association with larger regional economic powers. China, by virtue of its large market, mesmerizing growth, and masterful, full-range diplomacy, becomes the preeminent power in ASEAN's economic calculations. Economic dynamics lead to political pressures and identification, and ASEAN gradually loses its historical global orientation. The Asia-Pacific region ultimately realigns in a way that squeezes the American presence.

Scenario # 2: ASEAN integration fails, and the members drift apart in pursuit of their individual interests. Without the economic rationale to hold it together, ASEAN's political purpose also fails. ASEAN has achieved its greatest success as a political organization, mitigating conflict among its diverse membership, serving as a united front in dealing with threats, and providing a neutral forum for the interaction of Pacific powers. Its demise would create a dangerous vacuum.

Neither scenario would be good for America. ASEAN is at a crossroads. Its best future lies in creating a compelling economic story that can stand up to the scrutiny of investors and encompass the disparate economies of the region in a competitive, liberal economy of scale. The U.S. has a major interest in helping ASEAN to reach this goal.

What the U.S. Should Do

The United States should:

- **Stabilize the American diplomatic commitment to ASEAN.** Despite the U.S. government's best efforts at publicizing its interests and assets in ASEAN, there is a widespread perception that America's commitment to the region is declining. The sporadic involvement of the U.S. Secretary of State in the ASEAN Regional Forum and the President's recent cancellation of a heads-of-state summit with the ASEAN leaders have reinforced this perception and set back two years of progress in U.S.–ASEAN relations. Without high-level demonstrations of U.S. interests in the region, America's initiatives and advice are less effective, and the credit for its assistance will remain unclaimed.
- **Intensify U.S. Trade Representative involvement with the ASEAN economic ministers and associated forums.** Ambassador Susan Schwab's resumption of dialogue with her ASEAN counterparts two years ago is an important part of U.S. engagement. USTR officials have worked extensively with their counterparts. The consistency of this commitment is critical.
- **Expand the U.S.–ASEAN Trade and Investment Framework Arrangement (TIFA) work program** to address non-tariff barriers, barriers in cross-border services trade, and investment issues. In 2006, the U.S. and ASEAN signed a TIFA that established a process for addressing ASEAN-wide trade issues. The initial work program focuses on harmonizing select industry standards and facilitating trade flows. Progress has been made in these areas. The agenda should be expanded to include new areas that are critical both to current ASEAN commitments on integration and to American trade and investment.
- **Stay focused on an eventual U.S.–ASEAN free trade agreement (FTA).** The TIFA is an excellent plan B, and it can also help to lay the groundwork for an FTA. Ultimately, however, no instrument will drive ASEAN integration along a gold standard track like an FTA with the United States. Reconciling and harmonizing regulations across ASEAN for negotiations with the U.S. and ultimately committing to liberalization in the context of a WTO-compliant, enforceable FTA

would decisively lock in the economic reforms at the heart of ASEAN integration. The U.S. will not—and should not—negotiate an FTA that includes the Burmese junta, but it also should not allow Burma to block all forward progress on U.S.–ASEAN economic relations.

- **Continue looking for bilateral FTA opportunities.** Concluded broadly through the region, individual FTAs with the U.S. would commit the ASEAN countries to a common gold standard that can be applied on an intra-ASEAN basis. The U.S. should try to advance bilateral negotiations already opened (Thailand and Malaysia) and look for new opportunities, both bilateral and plurilateral.
- **Fully fund the ASEAN Development Vision to Advance National Cooperation and Economic Integration (ADVANCE).** ADVANCE is a five-year, \$150 million project to strengthen ASEAN and support its integration. It contributes most of the nuts and bolts to the ASEAN–U.S. Enhanced Partnership inaugurated by President George W. Bush in 2005 to provide a comprehensive framework for the U.S.–ASEAN relationship. The current level of funding is a good start, but the U.S. could do much better at matching its vision with resources.

Conclusion

ASEAN's ambition is clear, its record in implementing agreements to facilitate economic integration is spotty, and its commitment to economic freedom is subpar. ASEAN requires a resolution of vision to get to ASEAN Economic Community by 2015. It also needs the tools and resources to manage the undertaking effectively.

The U.S. cannot give ASEAN the political will that it needs, but by being involved in ASEAN's economic life at every important level, the U.S. can ensure that its advice and concerns are taken into account. The U.S. can also engage at the technical level in a way that enables the group to meet its objectives.

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