



## ISSUES IN REGIONAL ECONOMIC INTEGRATION: EVIDENCE FROM ASEAN FREE TRADE AREA

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In recent years, there have been many moves towards trade liberalization. In many cases, the effort has taken the form of a Regional Trade Agreement (RTA) in which countries have come together in a multilateral agreement via the World Trade Organization (WTO). For other countries, moves towards trade liberalization have been through regional agreements or bilateral arrangements. According to WTO, by 2007, about 300 RTAs have been notified to the GATT/WTO of which 194 were notified after January 1995. It is said that almost every country in the world has become a member of at least one agreement.

The basic theory of Economic Integration was produced by Balassa (1961) which shows that economic integration increases as trade barriers diminish. There are six degrees of economic integration. The weakest is a Preferential Trade Agreement (PTA), which allows for reduction in tariffs, but not their total elimination. A Free Trade Agreement (FTA) and Custom Union (CU) both aim to eliminate tariffs barrier between the member countries, but the former maintain their external tariffs on imports from the rest of the world. A Common market (CM) or Single Market not only establishes free trade area in good and services and sets external tariff among non-members, but it also allows for free mobility of capital and labor between member countries. The most advanced type of economic integration is Economic and Monetary Union, which sets up a CM, gives the responsibility for fiscal policy to a supra-national authority and adopts a common currency among member countries. These types of Economic Integration are also referred to as regionalism. Burfisher et al. (2003) describe that there is a major transition from a shallow to a deeper economic integration in the regionalism era in some RTA. The old version of regionalization is based on traditional trade theory that describes trade creation versus trade diversion adopted from the Viner-Meade (1950, 1955) theoretical framework. On the other hand, the new regionalism focuses more on broader issues such as the linkages between trade and productivity, rent-seeking behaviour, the role of FDI and productivity growth and the integration between developed and developing countries.

Regionalism has come late to Asia. ASEAN was among the first agreement on regional economic cooperation in East Asia. Unlike other regional associations in the world, ASEAN has no supranational authority or responsibility. However, there is an

annual meeting that discusses many issues including trade, investment, security, custom, tourism and others conducted by ASEAN Secretariat. Historically, ASEAN was formed on 8th August 1967 in Bangkok and its five original members are namely Indonesia, Malaysia, Thailand, the Philippines and Singapore. Cooperation in the economic, social, cultural, technical and educational areas was the main objective in Bangkok declaration. In addition, the aim was to promote regional peace and stability through abiding respect for justice and the rule of law in the region and adherence to the principles of the United Nations Charter.

The expansion of ASEAN's membership was the peak of a process of gradual rapprochement between the original ASEAN members and Brunei, Cambodia, Laos, Vietnam and Myanmar. On 8<sup>th</sup> January 1984, Brunei Darussalam became the sixth member of ASEAN followed by Vietnam on 28<sup>th</sup> July 1995, Laos and Myanmar on 23<sup>rd</sup> July 1997, and Cambodia on 30<sup>th</sup> April 1999. Since the birth of ASEAN, relationships among members have focused on political, social and security matters, with economic considerations being less prominent.

The process of regional economic integration in ASEAN continued with the formation of the ASEAN Free Trade Area (AFTA) at the fourth summit in Singapore in 1992. With this, ASEAN became the first organization in the East Asia region to aim at encouraging integrated economic cooperation. The main objective of AFTA is to increase the ASEAN region's competitive advantage as a single production unit. In order to promote greater economic efficiency, productivity and competitiveness, the Common Effective Preferential Tariff (CEPT) scheme required tariffs to be gradually reduced to the range 0-5 percent in 2003 between the six original members, Vietnam by 2006, Laos and Myanmar by 2008 and Cambodia by 2010.

Meanwhile, AFTA is still maintaining trade barriers from non-members at a level which was agreed upon as part of the Uruguay round. The key feature is the Common Effective Preferential Tariff (CEPT) scheme which covers manufactured products as well as agricultural products. Under the CEPT scheme, tariffs on a wide range of products traded within the region should be totally eliminated or at least reduced to a maximum of 5 percent. The

CEPT scheme classified products into three lists: the Inclusion list (IL), Temporary Exclusion List (TEL) and Sensitive List (SL). The elimination of tariff and non tariff barriers is expected to promote greater economic efficiency, productivity and competitiveness.

According to ASEAN Secretariat, the growth share of total ASEAN's trade continues to rise from 19.3% in 1993 to 22 % in 2003. In value terms, the level of trade volume has expanded more than double from US\$82.46billion to US\$174.25billion during the same period. In 1993, total ASEAN exports registered US\$206.6billion which has doubled in 2003 to US\$430.39 billion. Meanwhile the level of ASEAN's total imports has increased from US\$223.3 billion in 1993 to US\$539.32billion in 2003. Hence, the total trade for the region, which has a half billion people, was US\$969.71billion. The United States, Japan, The European Union, China and Korea remained as ASEAN's largest trading partners who have about 50% share of ASEAN trade.

When ASEAN was first established, trade among members was insignificant and relatively low. The share of ASEAN's trade between 1967 to early 1970s from ASEAN's total trade was between 12 to 15 percent only. AFTA should have contributed to the expansion of ASEAN's trade, both within and outside the region. In fact, in the last decade (1993-2003) intra ASEAN trade has been growing faster than total ASEAN exports.

Since 1992, the implementation of AFTA has created opportunities for greater expansion for both extra and intra-regional trade. Hence, to the new members, there are vast opportunities to be exploited from the original members through not only intra and extra-ASEAN-trade but also through intra as well as extra-ASEAN-foreign direct investment. Furthermore, the expanding membership in the ASEAN is seen as a process of learning and building confidence to face competition from outside the region. For the original members, the opportunity to become an investor is a golden chance to gain benefit by exploiting the supply of cheap labour. On the other hand, for the new members, the opportunity of opening up the market within the region can be seen as a trial before they really open up the market seriously to the global economy. Prior to their memberships, Vietnam and the three Indochinese countries were real threats and enemies to ASEAN. However, they now stand united to form regional cooperation. Through AFTA, they hope to stimulate domestic economic development, increase standards of living and impact the global markets further. Along with great diversity in size, economic and social institutions, natural and human resources, cultural background, language, race, religion and historical background, these countries vary at levels of economic development. The stability in the ASEAN region is important as it reflects the stability of the East Asia region specifically and the global economy as a whole.

In the beginning, the implementation of AFTA gave its original members challenges as they produced similar products and competed in the same market which then resulted in low intra-ASEAN trade. When new members were admitted to ASEAN, the challenges increased, since those new member countries were relatively low in their level of economic development. However, the blend of challenges and strong determination of all ASEAN members have created a new formula to boost the economy within the region. As a result, AFTA has had a positive impact on consumers, with a greater choice offered from a broad range of better quality products as well as an increase in economic growth, job creation and income. As far as FDI is concerned, it also gives investors more choices in deciding where to locate their operations for the increasingly integrated ASEAN market or for

export production elsewhere in the world. Whether a potential investor looks for high-technology capability, efficiency in services, abundant raw materials, or low-cost labor, these criteria can be found in any of the ASEAN countries.

The 1997 financial crisis which hurt most of the ASEAN countries was the biggest challenge to the association which reached 30 years old. The crisis did not only bring countries to poverty but it also impaired the economic systems which have been built for more than three decades. Some experts predicted that it would take a decade for ASEAN economies to recover and would result in broken ties of ASEAN10 (the original members and new members of ASEAN which consists of ten countries altogether). In contrast, the financial crisis appeared to have accelerated the progress towards closer integration. The ASEAN economy has bounced back within two years of crisis showing fundamental strength and resilience. In fact, the intra regional trade within the ASEAN continued to increase during the financial crisis.

Taking a lesson from the past economic turmoil, ASEAN took one step ahead to prevent recurrence of the crisis by setting up a framework for closer economic policies called ASEAN Surveillance Process (ASP). The vision 2020 becomes an ultimate goal to make the realization of mission and vision of ASEAN and AFTA. The establishment of ASEAN community which contains ASEAN Economic Community (AEC), ASEAN Security Community (ASC) and ASEAN Socio-Cultural Community (ASCC) has served as a roadmap for integration to be a single market and production base through free movement of goods, services, investments and capital by the year 2020. The ASEAN Investment Area for instance, aims to provide the environment that can facilitate a free flow of not only FDI, but also technologies and skilled workers. In addition, the scheme has been expanded to cover priority sectors in trade and also in services such as tourism, healthcare and air travel.

The growing concern related to the regional economic integration has raised attention to researchers to focus more on the impact of similar formations promoting economic integration. ASEAN, an example of the South-South Agreement at which the agreement signed between developing countries represents the only free trade area in the East Asia, can be as a model to other regional economic integration intending to involve deeper and wider the economic integration. To make each ASEAN country more competitive, there is much work to be done especially at the national level such as strengthening political stability, fostering a business-friendly environment and improving education and training sectors for global and regional competition.

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