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THE VARYING FORTUNES OF ASEAN ECONOMIC INTEGRATION: WHAT DOES THE HISTORICAL EXPERIENCE REVEAL?

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1. Introduction

In 2003, the Association of Southeast Asian Nations (ASEAN) embarked on an ambitious plan to create a single, integrated regional market and production space in Southeast Asia through the ASEAN Economic Community (AEC) project. The AEC is one of the three pillars of the ASEAN Community, the other two pillars being the ASEAN Security Community and the ASEAN Socio-Cultural Community. The AEC aims for the free flow of goods, services, investments, capital and skilled labour in the Southeast Asian region by 2015, a deadline that had been brought forward from the original 2020 completion date (ASEAN, 2003). The AEC builds on previous ASEAN projects on regional liberalization, notably the ASEAN Free Trade Area (AFTA), the ASEAN Investment Area (AIA) and the ASEAN Framework Agreement on Services (AFAS). Of these, only AFTA has achieved its target of reducing intra-ASEAN tariffs, with 98.3% of all traded products in 2008 placed in the Inclusion List of items subject to AFTA discipline, 88.5% of these having tariffs at the 0-5% AFTA target band and 63.4% of these with a zero tariff rate, while the average intra-regional tariff rate is 1.95%, down from 2.58% in 2007 (AEM, 2008). In designing the AEC as a comprehensive economic integration project, ASEAN policymakers recognized that while AFTA had registered tangible achievements in lowering tariff barriers within Southeast Asia, tariff reductions alone would not deliver the single regional market and production space that ASEAN leaders and officials believed was necessary for ASEAN's international competitiveness, particularly vis-à-vis the emerging economic giants of China and India.

Despite the ambitious commitments made and the adoption of detailed action plans to realize these commitments, scholars, policymakers and the business community have also recognized that there are considerable obstacles to meeting the AEC targets (ASEAN Study Centre, 2009). Their key concerns are with 'backsliding' by member governments on commitments already made or their unwillingness to commit sufficiently to integration targets in order to achieve the AEC goal. Thus, ASEAN member governments have been called on to display "strong political will" to ensure that deep integration is achieved on schedule (Hew, 2007b: 222). The call on ASEAN member governments to display "political will" is a familiar cry with respect to ASEAN cooperation initiatives more broadly, particularly (but not solely) in previous episodes of regional economic cooperation and liberalization.[1] AFTA, for instance, involved a long and rocky road of implementation setbacks that led many observers to even predict its failure at various junctures in its history (Nesadurai, 2003: 150). An earlier, first phase of ASEAN economic cooperation from 1977-91 was mostly a failure, which was attributed to the lack of "political will" on the part of governments to make good on the cooperation projects that had been adopted.

Three features have been common to ASEAN's past experiences in economic cooperation. This has been especially evident in AFTA, which had been adopted in 1992. First, ASEAN governments have generally been quite forthcoming when it came to initiating ambitious plans and programmes on economic cooperation and liberalization, committing to key targets even when these were potentially contentious. Second, despite these ambitious commitments, implementation faced numerous problems, with some member governments failing to meet set targets, either ignoring them or asking for revisions to original targets or seeking exemptions from them. Third, ASEAN governments have always preferred relatively limited institutional structures that in the end were unable to impose stronger discipline on member governments to adhere to the commitments, action plans and timelines to which they themselves had earlier agreed. ASEAN's preference was clearly for decentralized or inter-governmental mechanisms for decision-making, enforcement and adjudication that relied on flexibility and consensus and were, therefore, far less intrusive than supranational institutions or third-party mechanisms.

This paper examines whether these features that have characterized earlier episodes of regional economic cooperation and liberalization in ASEAN continue to characterize the present AEC project on regional economic integration. In other words, do the same forces that have shaped previous episodes of ASEAN economic cooperation also influence its current efforts in regional economic integration? This is an important question if we are to understand what drives ASEAN's ambitious commitment to deeper regional economic integration, evaluate the prospects for creating a single, regional market and production space as envisaged by the AEC project, and identify the difficulties that are likely to hinder the attainment of this goal. It is not sufficient to merely point to "lack of political will" to account for these difficulties; this explains little of the economic and especially the political dynamics underlying these trends. In addressing

[1] A comprehensive discussion of the evolution of ASEAN norms and institutional structures is found in Khong and Nesadurai (2007).

these questions, the paper draws on the AFTA experience for insights as to why ASEAN member governments are often prepared to commit themselves to a number of significant liberalization initiatives, but are then not always willing or able to implement the very commitments to which they had earlier agreed. The analysis also considers how member governments sought to address problems with non-compliance in AFTA and defuse the tensions and disputes that had arisen between member states, which almost led to a breakdown of the free trade area project. The aim of this historical analysis is to understand the political economy forces that have shaped the evolution of ASEAN economic cooperation in the past and to consider whether similar dynamics are at play in ASEAN's current project on regional economic integration under the AEC.

The paper proceeds in 5 parts. Following this Introduction, Section 2 outlines the conceptual framework that will be used to explain these varying fortunes in regional economic cooperation and liberalization, which in this paper is also referred to as economic regionalism. This section first reviews the different theoretical models that have been used in both the economics and political science literatures to explain why states might engage in economic regionalism, highlighting their strengths and/or weaknesses. It then explains why a conceptual framework that locates economic regionalist projects within the structures and processes of globalization on the one hand and within the structures and processes of the domestic political economy on the other hand is better placed to account for the emergence and evolution of contemporary regionalist projects like AFTA and the AEC. Section 3 applies this conceptual framework to explain the varying fortunes of ASEAN's record in regional economic cooperation and liberalization. Although the discussion also addresses the first phase of ASEAN economic cooperation from 1977 to 1991, the main focus of the discussion is AFTA, explaining why the AFTA project unfolded in the way that it did. Section 4 examines the AEC project in more detail, outlining what has been achieved thus far and what plans, targets and timelines have been set out to reach the AEC goal of a single regional market and production base. In this section, the paper uses the insights gained from the conceptual and historical discussion in Sections 2 and 3 to consider the prospects for making real gains in establishing a single regional market and production space in Southeast Asia by 2015.[2]

[2] Sections 2 and 3 of this paper draws from the author's earlier book-length study of the ASEAN Free Trade Area (AFTA). See Nesadurai (2003).

2. Explaining Contemporary Economic Regionalism: Bridging the Global-Domestic and Economics-Politics Divide

The decision by governments to participate in regional economic liberalization and integration projects – economic regionalism – has been explained in different ways by different disciplinary traditions. Neoclassical trade theory, specifically customs union theory, has been useful in pointing out how the balance between trade creation and trade diversion caused by these regionalist projects determines the net welfare gains that such projects generate for their participants. However, neoclassical approaches do a poor job of explaining *why* policymakers might wish to participate in regionalist schemes. The theory assumes that whether governments choose to participate in economic regionalism depends on these welfare calculations. However, in the neoclassical world where rational policymakers use all available information to choose the "correct" economic policy, it is difficult to explain why policymakers might wish to participate in schemes that are clearly second-best given their potential to cause trade diversion. Customs union theory suggests that the first best option will always be a global union, which avoids all trade diversion (Viner, 1955). Information deficiency is one way to account for "second-best" choices. Although neoclassical approaches do cite the role of politics in accounting for these second-best" choices, they are usually unable to say more on this point.

Explanations that emphasise strategic, foreign policy motivations perform better in bringing politics into the analysis (Hurrell, 1995: 49). The European Coal and Steel Community is a case in point, but even here, there were economic motivations that also prompted the decision to form the ECSC. In the Asia-Pacific, policymakers have cited "strengthening diplomatic relations with key trade partners" as their reason for pursuing bilateral free trade agreements in the new millennium (Dent, 2006). However, these strategic, foreign policy explanations go too far in the other direction by marginalizing economic calculations or motivations in these initiatives. Even the study by Dent shows that policymakers in the Asia Pacific region who pursued FTAs did so to elevate their diplomatic relations with their major *trading* partners, pointing to the implicit economic calculation in these diplomatic moves. The desire to expand a country's external market can also drive decisions to participate in FTAs that do not at the time in question display clear economic gains but this does not mean that the policy choice was driven by purely foreign policy calculations.

One common shortcoming of both strategic foreign policy and neoclassical accounts of regional integration is, therefore, their failure to analyze the economics-politics nexus. A second is the unsatisfactory way in which the global and domestic levels have been brought together in analysis while a third is their failure to open up the black box of the state to look more closely at domestic politics. The state is best captured by the metaphor of the two-faced Greek god, Janus, looking both inward to domestic society as well as to the external environment. Policymakers not only have to face other states and non-state actors at the international level, they also have to face their domestic constituencies, making policy choices likely to be the outcome of these twin interactions.

Insights from International Political Economy (IPE)

The discipline of International Political Economy (IPE), a branch of Political Science, offers a better conceptualization of the nexus between politics and economics, often regarded as analytically similar to the state-market nexus, as well as the nexus between the international and the domestic. Moreover, IPE approaches acknowledge the political dimension of the market. First, all forms of market, even free markets, are given their institutional form by political authority – the state/government – which consequently shapes economic outcomes even if it does not directly intervene in the market (Rodan, 1989: 4). Second, governments have long used the economy to attain particular social and political outcomes, true not only in Southeast Asia but worldwide as well (Beeson and Jayasuriya, 1998: 316; Underhill, 2000). Third, IPE also emphasizes the reciprocal connection between the control of economic resources in the market economy and the exercise of political power and influence (Underhill, 2000: 4). Thus, markets are not merely arenas for the efficient allocation of economic resources as in the neoclassical model; they also allow the allocation and consolidation of political power. This suggests that political leaders and policymakers will evaluate any development that affects the economy in terms of both its economic and political effects. Given this, explanations of why policymakers opt to participate in regional economic integration projects need to pay particular attention to the location of policymakers within domestic social and political contexts. Their location within the regional and world political economies is also vital because, as Hurrell (1995: 46) notes, there are no “self-contained” regions in the contemporary period wholly isolated from external influences. States, or national economies, need to be considered as constituent parts of the broader international system.

One IPE model of economic regionalism that pays attention to external economic influences as well as domestic politics is the functionalist or economic interdependence model. Mattli (1999: 42) argues that a policy of regional integration is more likely to be chosen, and more likely to succeed, if there is strong market-led pressure for cooperation arising from the significant "potential for economic gains from market exchange within a region". If regional economic interdependence is sufficiently high, and divergent national policies hamper the further extension of these economic interactions, then affected businesses are likely to lobby national governments to remove these policy-led impediments through some programme of regional collaboration (Haggard, 1997: 45-6). Political factors are integrated within the analysis through a pluralist model of domestic politics that explains governments' embrace of regionalist schemes in terms of business pressure on policymakers. Policymakers choose to supply regionalist projects in order to retain support from these key constituencies.

While the functionalist explanation is a useful corrective to the neoclassical and strategic foreign policy explanations discussed above, it is conceptually limited. First, this model fails to go beyond trade relations to also consider the dynamics of investment flows in explaining regionalism as a policy choice. This is a major gap considering the significance of worldwide investment flows from the late 1980s and the embrace by many developing countries, including in Southeast Asia, of a foreign direct investment (FDI) driven model of economic development. In fact, writings on AFTA had by the mid-1990s already pointed to the role of FDI in explaining its adoption (Ravenhill, 1995; Bowles and MacLean, 1996; Low, 1996; Chia, 1998; Menon, 1998). Second, the model fails to consider that convergent preferences for regionalism may be triggered by systemic pressures in the wider world economy beyond the region in question. This could prompt a turn to regional integration by similarly situated states even if economic interdependence in the region is regarded as "low". In fact, the IPE literature suggests that contemporary economic regionalism that took off from the late-1980s cannot be explained without explicit reference to the fundamental structural shifts that were taking place at that time and since then in the world political economy, changes that are best captured by the notion of globalization (Hurrell, 1995; Grugel and Hout, 1999).

Although globalization has been defined in many ways in various disciplines, for the purposes of this study it is best conceptualized as a multi-dimensional phenomenon that manifests itself through a variety of ways: (a) through the material economic outcomes associated with sharply intensifying and changing patterns of global market competition, such as shifts in prices, market shares, or profit rates; (b) through the prescriptions and proscriptions of the international institutions that govern the world economy (eg: IMF, WTO); and (c) through cognitive and ideational influences (Higgott, 2000:70).[3] The last set of influences draws attention to the ideologies that are associated with globalization and the perceptions and images that actors hold about it. In fact, a growing body of IPE scholars acknowledges that the perception of intensified market competition is possibly the main cause of changing behaviour in the contemporary period (Palan and Abbot, 1996: 32). Policymakers may respond in anticipatory fashion to perceived global market competition to stay one step ahead of the game even if there are no serious market pressures on the economy at the time the decision was taken. What this also implies is the possibility for agency – that actors like governments use regionalism as one way of responding to what they see as external pressures coming from fundamental shifts in the world economy.

Four models of economic regionalism

The IPE literature has identified four ideal-type models of economic regionalism that are, in one way or another, outcomes of globalization: open regionalism, the resistance model, an FDI variant of open regionalism, and developmental regionalism. (See Table 1). Open regionalism is a term used to describe regionalist schemes that are fundamentally aimed at enhancing members' links with the global economy.[4] They are building blocks to global market integration. The neoliberal variant of open regionalism is underwritten by a strong neoliberal economic policy agenda emphasizing liberalization, deregulation and privatization of state functions in the economy for efficiency gains. In this form of regionalism, national economies are subordinated to what are considered to be the beneficial forces of the global market. Governments seeking to enhance the competitiveness of their respective national economies collaborate with each other to undertake coordinated liberalization and deregulation of their economies, in the process building regional spaces of neoliberal governance (Grugel and Hout, 1999: 10; Hveem, 2000: 70-4; Mittelman, 2000: 121). Regional rather than global collaboration is chosen as the former is easier to

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[3] In IPE, globalization is distinguished from economic interdependence or internationalization. Internationalization and is best regarded as a property of the units (eg states or firms) that make up the system, namely their individual degree of openness to, or participation in, the world economy. Globalization is best seen as a property of the *system* that consequently structures the environment in which these units have to operate.

[4] The original notion of open regionalism, developed by Drysdale and Garnaut (1993: 187-8), meant a form of regionalism based on the principles of unilateral liberalization rather than formally negotiated liberalization, as well as non-discrimination in the offer of preferences to regional members as well as non-members. It was, therefore, non-preferential. The Drysdale and Garnaut model should be contrasted with the IPE notion of open regionalism, which emphasizes its preferential nature although the exchange of preferences amongst members is not accompanied by the imposition of new barriers against non-members (Gamble and Payne, 1996: 251). It is "open" to the extent that this form of regionalism does not aim at reducing the regional group's linkages with the world economy but is aimed at enhancing its participation in it.

accomplish, involving a smaller number of players (Oye, 1985). However, by acting as a signaling device and as a source of pressure for other states and regions, open regionalism can lead to competitive liberalization elsewhere. The Information Technology Agreement (ITA) initially adopted by APEC member economies in 1996, and later adopted by the WTO, is a case in point. In contrast, the resistance model of regionalism seeks to preserve through regionalism particular forms of national policy instruments or domestic social arrangements such as the welfare state that may be difficult to sustain individually amidst the competitive pressures associated with globalization (Mittelman, 2000: 116-30). Governments are driven to collaborate with other like-minded governments in this endeavour in order to preserve their domestic political legitimacy, which is bound up with their continued protection of redistributive goals such as found in the welfare state (Kurzer, 1993: 254). Both open regionalism and the resistance model were the two ideal type models of economic regionalism found in the early IPE literature.

Two further theoretical models were later developed that incorporate a deeper notion of both international and domestic politics and that consequently highlight a more sophisticated account of state agency (see Nesadurai, 2003: 37- 49). In the neoliberal version of open regionalism, there is very little purposeful political action by governments to intervene in globalization processes except to acquiesce in and act in accordance with the logic of global market forces. This model is also silent on domestic distributive issues. Although the resistance model integrates domestic politics in explanation, this model assumes that governments that care about their domestic political legitimacy will always seek to resist the pressures of globalization, choosing regionalism as their instrument to achieve this. Yet, in parts of the world like Southeast Asia, it is governments' ability to deliver material economic well-being, in addition to social and political stability, that accords them political legitimacy. In these states, high rates of economic growth not only satisfy mass aspirations for material well-being, they also allow elites to maintain their right to rule (Case, 1996: 18). In such instances, concern with legitimacy could entrench open regionalist projects that conform to the globalization logic if these work to enhance growth.

In attempting to overcome the limitations of these early models and add to the set of possible ways in which regionalism relates to globalization, two conceptual moves were made (Nesadurai, 2003: 37-43). The first move, which draws on economic realist theorizing in IPE, is to recognize that policymakers will attempt to intervene in markets to enhance their chances of hosting valuable economic activities in their respective states. The second move is to recognize the complexities of domestic politics that go beyond pluralist models or that associate legitimacy purely with redistributive policies. Political actors everywhere, including in authoritarian settings, are usually confronted by the choice of adopting policies that maximize wealth in society as a whole or that benefit particularistic interests; to put it simply, between concern over growth or domestic distributive priorities.[5] Which priority – growth or distribution – dominates in official decision-making will depend on the political costs to incumbent leaders and policymakers of making a choice between the two and will be contingent on prevailing political and economic circumstances as well as the socio-political bargains that have been struck between state and society.[6] In the elite governance model of domestic politics, which is salient to the Southeast Asian context, political legitimacy is based on such bargains struck between political elites and society, which can differ in different states (Case, 1996). As a result of these two moves, two further models of economic regionalism have been developed – an FDI variant of open regionalism and developmental regionalism (see Table 1).

The FDI variant of open regionalism builds on the political economy works on AFTA that emphasize the key role of FDI rather than trade in prompting governments to participate in regional integration projects. However, the FDI model of economic regionalism goes further that these studies by showing how the changing dynamics of global production and corporate strategy from the 1980s – a key feature of globalization – make large, integrated geographical spaces valuable to foreign investors, in turn, opening up political space for governments to actively use regional integration as a strategic policy tool to attract globally mobile investment to the region. By collaborating in this way, small, individual states within that regional group enhance their chances that they *might* be the preferred site for the incoming capital, which would otherwise have located away from the region. By the late 1980s, global investors were already displaying a clear interest in establishing regional production networks (Rodan, 1993; Oman, 1994: 17: Dicken, 1998: 216-7), with corporate leaders emphasizing "access to large regional markets" when deciding where to locate their investments (Walter, 2000: 65). This model of regionalism is likely to appeal to states in which FDI is a key source of growth, such as in Southeast Asia. In such instances, regionalism may be driven less by a neoliberal policy agenda as in the neoliberal version of open regionalism than by concerns with attracting or remaining attractive to FDI. While these projects are aimed at remaining linked with the

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[5] Distribution may be defined as the deliberate allocation of income, rents and other economic benefits by governments to particular individuals, groups or firms who would otherwise not have received these gains through the unmediated workings of the free market (Nesadurai, 2003: 43).

[6] Although distributive policies are not always incompatible with growth, maintaining an analytical distinction between them is useful as it points to different policy choices that need to be made, trade-offs that may need to be reconciled and the implications of such choices for external policy, including on regional integration.

global economy, they are also consistent with a degree of government intervention in markets and may display only a limited neoliberal, deregulatory agenda.

A fourth ideal-type model of economic regionalism emerges once a distinction is made between foreign-owned and domestic-owned capital. Neither the neoliberal nor the FDI variants of open regionalism makes such a distinction. Although it may be difficult in the real world to distinguish business in terms of its nationality (i.e foreign or domestic) – the "who is US?" questioned posed by Robert Reich (1991: 304) – such a distinction remains analytically relevant in settings where policymakers and politicians do make such a differentiation for political reasons. In such settings, particularly in developing states where domestic or national capital is not as well developed as foreign capital but often plays a crucial social/political role, governments may well respond to external pressures associated with globalization in ways that attempt to preserve or nurture domestic capital. In what I have called 'developmental regionalism',[7] two instruments are used to help emerging domestic firms become internationally competitive: one, the expanded regional market created through regional liberalization, and two, temporary protection or privileges for domestic capital in this expanded market. According to strategic trade theory, both measures together can theoretically help secure benefits for domestic firms over their more advanced, foreign competitors (Nesadurai, 2003: 41-43).[8] Although we may regard the concern with domestic capital as a concern with distribution, since it involves selectively allocating benefits to domestic-owned firms, the concern with growth is not entirely absent from this model. Rather, the growth imperative is infused with distributive concerns. Developmental regionalism is, thus, not about resisting market competition completely, but neither is it about complete acquiescence to global market forces. Instead, states actively accord domestic/regional firms temporary and limited protection from the highly competitive global corporations that are such a feature of the globalizing world economy, using this period of 'shelter' to help domestic firms to grow and to be able to eventually participate in global market competition.

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[7] This model of developmental regionalism is distinct from the notion of strategic trade regionalism developed by Gamble and Payne (1996: 252), which does not distinguish between foreign-owned and domestic-owned capital. Neither is developmental regionalism similar to Mittelman's (2000: 116-7) model of development integration in which states allocate industrial projects amongst the members of regionalist projects.

[8] Paul Krugman's 'import protection as export promotion' strategic trade model suggest that when a domestic firm is given a privileged position in the home market, it enjoys an advantage in scale over foreign rivals that enables the firm to realize 'learning by doing' benefits (Krugman, 1984). A larger, protected 'home' market, such as a regionalist scheme, will offer greater dynamic scale and learning effects to the privileged firm.

Why policymakers would wish to privilege domestic firms depends on the particular nature of relations between state and society, relations that can differ across different countries. Although foreign capital was, and remains, a crucial source of growth and exports in the ASEAN states, many of these governments are at the same time committed to nurturing domestic-owned capital for a variety of reasons (see Nesadurai, 2003: 116-24). In some instances, this occurs because governments are committed to a broadly nationalist agenda of empowering the state, or governments may subscribe to a developmentalist agenda of creating high performing domestic/national firms. In other instances, domestic capital, or rather, segments of domestic capital (individual corporate leaders and their respective firms or industry group) may be privileged because these are closely allied to political elites or because of other social bargains such as in Malaysia, for instance, where ethnic Malays are constitutionally accorded special economic privileges to enhance their share of economic wealth and entrench this group's political power (Jesudason, 1989).[9]

Domestic distributive politics and regional distributive bargaining

Domestic distributive agendas of the sort described above can lead to conflicts not only within states, they are likely to result in conflicts between the member states of the regional project. As Haggard (1997: 21) notes, "distributive conflicts …are at the core of any regional arrangement". If these conflicts are not addressed, they can undermine completion of the regional agreement. Although implementation can be undermined by weak state capacity arising from insufficient financial, technical or administrative resources, this problem may be easier to address than implementation setbacks arising from domestic distributive conflicts, which are highly politically charged. In such cases, domestic distributive politics often becomes linked to distributive bargaining at the regional level (Haggard, 1997: 33).

One way to address compliance problems and avoid political bargaining over implementation is by establishing institutions to govern the integration process. Rule-based mechanisms that monitor compliance, provide for the resolution of disputes, and punish violations from the agreement are argued to be necessary to the successful completion of integration schemes. Third-party or supranational bodies also help reduce the possibility of political bargaining in these implementation processes. Given states' need to meet their institutional obligations, and particularly if the cost of violation is sufficiently high, policymakers are likely

[9] Malaysia's ethnic-based affirmative action programme is formally aimed at aiding *Bumiputera*, a category that includes ethnic Malays as well as the indigenous groups of East Malaysia and Peninsular Malaysia.

to resist demands from domestic industries to delay regional liberalization, using a variety of means to compensate losers including providing technical and financial adjustment support. States also attempt to strike new domestic socio-political bargains that permit the regional project to proceed. The supranational institutions of the European Union as well as the inter-governmental institutions of NAFTA exemplify this model of implementation (Martin and Simmons, 1998).

In cases where the process of reworking domestic bargains is difficult to achieve domestically, reworking often ends up taking place at the regional level through political negotiations and bargaining (Chayes and Chayes, 1995: 25). Compliance bargaining, which is quite common in international negotiations, allows for new distributive bargains to be struck at the regional level through compromises that allow departures from the original agreement. However, to maintain credibility of the project and to minimize future non-compliance, other members usually seek to introduce some degree of institutional strengthening by tightening rules and procedures, enhancing transparency, and improving the capacity for monitoring and settling disputes. In compliance bargaining, gains and losses are, therefore, traded between participating states. When compliance bargaining takes place and original commitments are revised downwards, gains are transferred to the offender from those states for which the original target was superior. This process offers some space for the offending party to address domestic concerns. Yet, all parties can gain over the long run since this act allows the cooperative project to be maintained, provided all parties remain convinced that the project is sufficiently valuable. The alternative could well have been the project's collapse.

In the following section, the paper uses the conceptual insights discussed in this section to read ASEAN's historical experience with regional economic cooperation and liberalization while Section 4 examines ASEAN's current regional integration experience.

3. ASEAN's Historical Record of Economic Cooperation and Liberalization: 1977-1991

Economic cooperation in ASEAN was formally initiated in 1977. Although the 1967 Bangkok Declaration establishing ASEAN highlighted economic cooperation as a key goal (ASEAN, 1967), no concrete projects in this area had been developed. Instead, ASEAN focused on building confidence amongst its members through regular consultations on a host of shared intra-regional and wider political and security issues

(Antolik, 1986: 17-19). The emphasis on regional confidence building and the search for mutual accommodation, peace and security amongst regional states was unsurprising given that ASEAN's formation in 1967 had been primarily aimed at overcoming intra-regional tensions and rivalries that had dominated regional relations throughout the 1960s. ASEAN's early goal of regional rapprochement was crucial as it allowed member governments to devote their full attention to national economic growth and development, which was believed to be the primary route to social and political stability in these mostly divided post-colonial societies, and a means, therefore, for ruling governments to secure political legitimacy (Leifer, 1989: 3-4). Sovereignty and non-interference were, consequently, cardinal norms of the Association.

The First Phase of ASEAN Economic Cooperation, 1977-91

The primary impetus for economic cooperation in 1977 was external -- the fall of South Vietnam in 1975 – which led the ASEAN member states to consider moves that would enhance their security by strengthening cohesion within ASEAN. One route chosen to enhance regional cohesion was economic cooperation, which led to four regional economic projects. The Preferential Trade Arrangement (PTA) and the ASEAN Industrial Projects (AIP) were both launched in 1977, the ASEAN Industrial Complementation project was launched in 1981 and the ASEAN Industrial Joint Ventures (AIJV) project was initiated in 1983.[10] Unfortunately, these four projects were unsuccessful. It is difficult to sustain politically-motivated projects if their economic costs are too high and not sufficiently offset by their political gains. Aside from the elusive nature of these projects' non-economic benefits, a number of them also posed significant economic and political costs as they interfered with national development agendas.

While the tariff liberalisation PTA scheme threatened domestic industries and firms, the AIP saw each government clamouring to host the same industrial project. More than that, there had been no pressing economic need for a regional market during the 1970s and 1980s since all the ASEAN countries were trading far more with industrialized countries than with each other. As a result, governments had no incentive to overcome their different national interests and ensure the proper design and implementation of these projects. Although these economic projects theoretically offered the small ASEAN countries a larger

[10] For a discussion of the political economy of this first phase of ASEAN economic cooperation, see Suriyamongkol (1988).

regional market to support the domestic industries that were being encouraged through import-substitution industrialisation, each government also wished to preserve its own domestic market for domestic firms, especially politically important ones, thereby making it difficult to move regional economic cooperation beyond identification of new projects or the early stages of their implementation (Ravenhill, 1995: 852-53). Neither were officials and leaders enthusiastic about regional free trade schemes during the 1970s and 1980s as they saw these projects as *alternatives* to participation in world markets (Bowles and MacLean, 1996: 332-33). An ASEAN-wide free trade area – AFTA – became possible only when it became clear that regional free trade schemes could enhance countries' *integration* with world markets rather than precipitate their exclusion from it.

AFTA (1992-2002): Ambitious Commitments, Problematic Implementation

The decision by six ASEAN leaders in 1991 to form AFTA was surprising given the difficulties the grouping had experienced in pursuing regional economic cooperation in the past and its constant rejection of the idea of a free trade area in ASEAN.[11] There was also considerable scepticism amongst scholars and the business community that the project would succeed, even in its initial limited form. The project was originally designed to lower tariffs on manufactured goods and processed agricultural products to between 0-5 percent by 2008 over a fifteen-year period beginning in January 1992. Regional tariff liberalization would take place through the Common Effective Preferential Tariff (CEPT) scheme. Critics charged that the economic welfare gains from such a project were insufficient to sustain a free trade area, particularly since member countries did not trade much with each other and were instead far more closely linked through trade and investment flows with non-ASEAN countries. In 1990, intra-ASEAN exports among the six members constituted about 20 percent of their total trade while their exports to the industrial countries totalled 58 percent of total exports.[12] Despite its presumed lack of economic incentives, AFTA went ahead, and later, its pace accelerated and its scope expanded from what was initially planned. Its six founding members agreed to reduce tariffs on all manufactured goods and processed agricultural products to 0-5 percent by 2002 and to zero by 2010. In the mid-1990s, the regional liberalisation agenda was expanded to include unprocessed agricultural products, services and investment, all potentially contentious issue areas that member governments had initially excluded from regional liberalisation. Investment was governed by the ASEAN Investment Area (AIA) programme while services liberalisation was governed by the ASEAN

[11] The founding members of AFTA are Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand.

[12] Calculated from IMF (1996).

Framework Agreement on Services (AFAS). Both may be regarded as components of a broader AFTA project to create a single regional market in Southeast Asia. These developments in AFTA raise a key question: why did member states make these ambitious commitments despite the lack of clear economic incentives or welfare gains from the project and the contentious nature of some aspects of the regional liberalization agenda?

AFTA and the FDI Imperative

Although ASEAN officials and leaders initially saw AFTA as a project that would give ASEAN renewed purpose following the end of the Cold War and the resolution of the Cambodian conflict,[13] officials and leaders only became fully convinced of the project's value when they realised that AFTA offered them a way to maintain their respective countries' attractiveness to FDI (Akrasanee and Stifel, 1992). Five of the original ASEAN members by this time were facing declining foreign investor interest in their economies, seen in the fall in applications for foreign investment approvals.[14] By 1992, the ASEAN leaders had become anxious that any further diversion of FDI from the region would disrupt economic growth. In reality, the FDI situation was not that dire. But, it was how officials and leaders interpreted these declining trends in the face of what were fundamental shifts in the world economy that played a key role in their decision to form AFTA. As already noted, decision-makers do not only respond to an 'objective situational structure', their responses are shaped by how they interpret their material circumstances (Beckert, 1999: 14).[15]

When ASEAN senior officials were charting new directions for the Association following the resolution of the Cambodian conflict, they also noted the extensive analyses undertaken by European and North American economists and policy analysts on the implications for ASEAN of the impending North American Free Trade Area (NAFTA) and the Single European Market (SEM). Most of these studies pointed out that rather than causing trade diversion, NAFTA and the SEM would seriously disrupt *FDI flows* to ASEAN (Means, 1995). Read together with the fall in foreign investment applications, these

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[13] ASEAN had become so focused in the 1980s on finding a solution to the Cambodian crisis that it was criticized for turning into a single-issue organization. The resolution of the crisis raised concerns that ASEAN would unravel as there did not seem to be any other purpose holding the Association together.

[14] ASEAN's share of global FDI flows declined from a high of 35 per cent in 1990 to 24.3 per cent by 1992 (Nesadurai, 2003: 81, Table 3.1).

[15] This is a sociological or constructivist approach to decision-making and behaviour.

studies convinced decision-makers that FDI diversion would be the major fallout of the turn to regionalism in North America and Western Europe. They were equally convinced that a similar regional project in ASEAN would be the most appropriate policy response. They also believed that AFTA could help them meet the FDI challenge from an emerging China, which offered investors a potentially huge market and production base all within one political territory. The views of ASEAN leaders and officials can be summed up in the words of Thailand's Prime Minister in 1993, Chuan Leekpai who argued that 'possible diversion of direct foreign investment … is a perpetual reminder that smaller countries have to unite'.[16] Rather than seeking to expand intra-regional trade *per se,* officials and leaders were looking to attract foreign investment to the region by creating a large geographical economic space in Southeast Asia through AFTA. ASEAN leaders also faced little opposition to this plan from domestic businesses who were, in fact, sceptical about the AFTA idea and did not believe the project would even get off the ground. Only the ASEAN Chambers of Commerce and Industry endorsed AFTA; this peak business group had, in fact, been trying to convince ASEAN leaders for the best part of a decade to establish a free trade area in ASEAN (Bowles and MacLean, 1996).

Balancing Global Pressures and Domestic Political Imperatives

Their conviction that AFTA was needed to stave off an FDI crisis coupled with the lack of official business opposition to the project led the ASEAN member governments to make ambitious commitments for regional liberalisation. However, once the official decision had been made and publicly announced, opposition to the project quickly emerged from domestic business interests, particularly in Thailand, the Philippines and Indonesia. These included, for instance, the Philippines Chamber of Commerce and Industry, the Indonesian Automobile Industry Association (GAIKINDO), the Thai petrochemical industry, Thai electronics, plastics product and iron and steel firms, and Philippine apparel, footwear and iron and steel firms (Nesadurai, 2003: 129). On the other hand, other business actors from these countries supported AFTA. Indonesian businesses with export capabilities like the Salim group wanted AFTA hastened for some products while export-oriented Philippine and Thai industrialists welcomed the adoption of AFTA as did the Federation of Malaysian Manufacturers (ibid).

[16] *Business Times*, 'Stepped-up liberalisation of trade can be expected: Chuan', 8 January 1993.

Because of the overriding concern of the ASEAN governments with growth, using AFTA to create a regional market to which foreign investors would be attracted, governments generally resisted demands from firms wishing to delay tariff liberalisation. Governments were, nevertheless, sympathetic to business concerns worried about the consequences of regional trade liberalisation and dealt with them in various ways. One was to provide domestic adjustment measures to help firms, such as financial and technical assistance, reduced utility charges, as well as fiscal incentives (ibid). However, a number of ASEAN governments soon began exempting a good many products from the CEPT scheme in order to shield favoured domestic industries and firms from regional liberalization. Free-riding became possible because the ASEAN governments, following long-standing practice, had not created binding rules, unambiguous timelines and targets, as well as mechanisms to monitor and enforce AFTA.

A number of governments went back on their original first set of AFTA commitments due for implementation in 1995. Indonesia, for instance, raised tariffs on selected petrochemical products in the mid-1990s without any prior warning to its AFTA partners. It also withdrew a range of agricultural items from AFTA. Prominent business firms operated in these sectors, such as PT Chandra Asri (petrochemicals) and firms engaged in cloves, wheat and sugar production that were also linked to the family of Indonesian President Suharto (Nesadurai, 2003: 128-50). The ASEAN response was to work out a new compromise through re-negotiating the CEPT scheme. Member states agreed to review the original liberalization schedules for a number of sensitive agricultural products, allowing an extended period of time before liberalisation had to be completed. This move also allowed governments to protect the livelihoods of key constituencies like rural rice farmers. Other demands to delay AFTA commitments later emerged from politically influential firms or politically important sectors that weakened governments' commitment to AFTA. The Malaysian government negotiated to withdraw automobiles from AFTA disciplines to protect the national car project despite opposition from the Thai government and from foreign automobile producers. In a similar move, four ASEAN countries – Indonesia, Thailand, Malaysia and the Philippines – attempted to delay regional liberalisation of the petrochemicals sector, designated a strategic sector in these states although only the Philippines later sought to temporarily withdraw petrochemicals from the CEPT scheme. Renegotiation was adopted in all these cases to allow affected governments to assuage politically influential domestic corporate players who had found a more rapid pace of liberalization threatening to their business interests.

Aside from these cases, however, the ASEAN governments have been quite resistant to demands from domestic businesses to delay CEPT implementation, including during the 1997-98 financial crisis period. Although import restrictions were adopted during 1998-99 in a number of the ASEAN countries, these were temporary, a direct response to the crisis-induced economic slowdown, and thus not significant instances of protectionism. While the head of the National Business Development Centre in Indonesia called for the 2003 target date for the CEPT to be postponed to 2010 in view of the regional economic crisis, the government's economic advisory council rejected the demand.[17] By this time, Indonesia had adopted the IMF bailout package of reforms, and reneging on the CEPT would not have sent the right signals to the international investors that the country was keen to attract. The Federation of Philippine Industries also asked the government to suspend CEPT implementation until 2003[18] but its demand was not entertained although the government in September 2002 signalled its intention to temporarily exclude petrochemicals from the CEPT, as Malaysia had done with automobiles.[19] Similarly, the Thai government refused to accede to business demands to delay the CEPT.[20] Although Malaysia excluded automobiles from the CEPT, the government, on the explicit instruction of the Prime Minister, rejected all other business demands to delay tariff liberalisation for other products, including automotive parts and components.[21] In the end, AFTA saw significant delays mostly in the regional liberalization of agriculture, petrochemicals by the Philippines and automobiles by Malaysia. In these cases, the interests of politically well-connected domestic firms were able to weaken the government's original commitment to regional liberalization (Nesadurai, 2003: 132-50). The distributive imperative clearly intruded into the growth imperative and led to these implementation setbacks in AFTA. Similar dynamics were evident in the AIA and AFAS.

In services, for instance, the ASEAN governments found it especially difficult to advance their negotiations to obtain specific commitments to liberalise the financial and telecommunications sectors. Malaysia was especially unwilling to consider liberalising foreign equity and market access conditions for financial services, which Singapore and Thailand favoured. This is unsurprising, since domestic banks were key

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[17] *Jakarta Post*, 'Local businessmen want implementation of AFTA delayed', 12 July 2000.

[18] *Business Times*, 'Philippine industries want tariff freeze until 2003', 4 September 1998.

[19] *Business Times*, 'No delay in the implementation of AFTA' 12 September 2002.

[20] Author's interview with senior official, Thai Ministry of Agriculture, August 2000, reported in Nesadurai (2003: 130).

[21] Author's interview with a Malaysian trade official, August 2000, reported in Nesadurai (2003: 130).

players in the Malaysian political economy, and liberalisation would have reduced the space for patronage-based manoeuvring to take place (Gomez and Jomo 1997). Similarly, domestic firms with strong ties to the political elite, such as the Renong Group, were prominent players in telecommunications, which made it difficult for the Malaysian government to commit to broad-based liberalisation in this sector that might have jeopardised the dominant domestic position of these firms. Regional liberalisation also became a casualty of intra-ASEAN suspicions. For instance, the Malaysian government rejected a proposal by the Renong Group, a prominent Malaysian conglomerate, to form a strategic tie-up with Singapore Telecommunications (SingTel), a corporation linked to the Singapore government.[22] The Malaysian Prime Minister had reportedly been against the idea of a close connection between Renong, which had close ties with the ruling Malay party, UMNO, and the Singapore government.[23] Singapore and Thailand were unhappy with Malaysia's hesitant market opening offers in the finance and telecommunications sectors. Advancing negotiations in these sectors was important since domestic capital in these two states was concentrated in finance and telecommunications and was looking to the regional market for expansion.

Despite their reliance on foreign capital for growth, some ASEAN member governments also subscribed to nationalist aspirations to develop local entrepreneurs and firms. This led them to be wary of an overly rapid pace of investment liberalization. In fact, the design of investment liberalization through the 1998 AIA scheme clearly resembled the model of 'developmental regionalism' described in the previous section (Nesadurai, 2003: 99-127). The AIA offered market access and national treatment investment privileges to ASEAN national investors (both state and private investors) ten years ahead of non-ASEAN investors. This, coupled with the expanded regional market formed via trade liberalization, was seen as one measure to nurture the growth of fledgling domestic firms. The original aim of the AIA Scheme had been to complement AFTA's CEPT Scheme. Despite the ASEAN countries' embrace of FDI, foreign investors continued to face restrictions on which sectors they could freely enter, the ownership structures of their ventures, and the kinds of incentives their firms could gain from host governments. The AIA Scheme had been initiated to begin the process of liberalising investment rules within ASEAN. However, the Malaysian and Indonesian governments lobbied for domestic, ASEAN firms to be accorded preferential treatment over foreign (non-ASEAN) firms in the AIA Scheme as one way to help nurture the expansion of ASEAN firms in the regional market. However, this 'developmental' approach to regionalism was overturned in 2001 as

[22] Details of the episode are found in *Far Eastern Economic Review*, 'Changing lanes', 8 June 2000.

[23] UMNO is the United Malays National Organization, the dominant ethnic-Malay party in the *Barisan Nasional* coalition that has ruled Malaysia since independence in 1957.

member states decided to re-emphasise the regional market's FDI-attracting role when global recessionary pressures emerged that year. The ASEAN governments were concerned lest the discriminatory (to foreign firms) elements in the AIA Scheme sent the wrong signals to foreign investors during a period when the task of sustaining economic growth through FDI became even more critical. However, the AIA continued to maintain the foreign-ASEAN distinction in its offer of investment privileges in ASEAN until August 2008 when the ASEAN Comprehensive Investment Agreement (ACIA) was adopted. Under this revised investment agreement, ASEAN-based foreign investors investing in another ASEAN state will be accorded national treatment and market access privileges (AEM, 2008). This shift in policy is unsurprising in view of the ASEAN preoccupation with remaining attractive to FDI. However, ASEAN's initial developmental approach to the AIA reveals the long-standing emphasis in the region with nurturing domestic firms.

Domestic Priorities, Implementation Setbacks: Renegotiating AFTA, Strengthening Regional Institutions

Despite their keenness to employ AFTA as a regional market creation strategy through which to attract FDI or as a way to nurture domestic ASEAN investors, the ASEAN governments, following long-standing ASEAN norms of informality, flexibility and consensus decision-making, did not put in place strong institutional mechanisms to bind members to implement their liberalization commitments. The paucity of rules, the inadequate attention paid to monitoring compliance, and the absence of a dispute settlement mechanism were detrimental to the chances of successful regional liberalisation. However, while implementation setbacks led to the downward revision of original targets, institutional strengthening also took place as those ASEAN states hurt by these revisions sought to prevent similar incidents in the future. They also sought to reassure investors that AFTA was not about to be abandoned. By this time, businesses had begun taking AFTA seriously and wanted ASEAN to make explicit its commitment to AFTA (Nesadurai, 2003: 185).

As a result of compliance bargaining, ASEAN member governments adopted clearer target dates for liberalization and drew up new rules to govern temporary exclusions from regional liberalisation, including outlining timetables for ending these exclusions. They also adopted three new sets of detailed and binding procedural rules: a dispute settlement mechanism in 1996, a notification protocol in 1998 that obliged members to notify ASEAN before altering or withdrawing concessions already offered, and in 2000 a protocol to govern the modification of liberalisation commitments agreed to earlier (ASEAN, 1996, 1998 & 2000). The Protocol on Sensitive and Highly Sensitive Agricultural Products adopted in 1999 provides rules to govern agricultural trade liberalisation, including provisions for its flexible implementation and rules on exempting sensitive agricultural items (ASEAN, 1999). Although renegotiation meant that there was a failure to realise the original targets of AFTA as these were revised downwards, renegotiation, paradoxically, may have been crucial to the project's survival despite being a "second-best" outcome. Otherwise, officials conceded that the AFTA project was in danger of collapsing (Nesadurai, 2003: 168-70). Although the revision of original targets downwards was not an ideal arrangement for all parties, it was the best available option that allowed the ASEAN governments to maintain what was for them a valuable project of economic cooperation. Renegotiation permitted costs and benefits to be redistributed between member states (and firms) as original targets were revised downwards. Rule building, the other outcome of renegotiation performed an information function by signalling to business investors that regional economic liberalisation remained on the cards, though under a revised schedule.[24]

These new rules, however, could not in themselves prevent members from reneging on their AFTA commitments if, for them, short-term domestic gains exceeded the costs of defection and trumped longer-term group benefits. For instance, the Philippines in 2002 was prepared to suffer the costs of opting to temporarily delay regional liberalisation of petrochemical products. Compensation was required under the new modification protocol adopted in 2000, but for the Philippines, there were domestic gains to be had from delaying regional liberalisation of an industry accorded the status of a strategic industry (Yoshimatsu, 2006).[25] Similarly, the Philippines government announced in September 2009 that it is negotiating to delay liberalisation of rice tariffs, currently at 40%. Rice is due to be transferred to the CEPT Inclusion List by 2010 and tariffs reduced to between 0-5% in accordance with the deadline for liberalizing sensitive agricultural products negotiated under the 1999 Protocol. A response to heavy domestic pressure from farmers' groups and NGOs, the revised proposal by the Philippine government will see rice tariffs minimally reduced to 35% in 2015. Thailand, ASEAN's major rice exporter is reportedly unwilling to accept the Philippine request.[26] It is clear that unless adequate domestic adjustment measures are adopted, domestic development agendas revised and new domestic social bargains struck, stronger institutional rules may not be sufficient to prevent governments from reneging on their commitments unless the costs of non-compliance – in the form of compensation and reputational costs – are sufficiently high.

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[24] See the views of the US-ASEAN Business Council, reported in PricewaterhouseCoopers (2000).

[25] Malaysia and Thailand were unable to agree on the amount of compensation the former had to pay (Lim, 2008: 311).

[26] *Business Mirror*, 'RP seeks slower tariff reduction for rice under AFTA', 13 September 2009.

AFTA and a single regional market: Success of failure?

The end of 2002 saw the successful conclusion of the first phase of AFTA, with tariffs on 99 percent of all products from the six founding members of AFTA set below the targeted 5 percent and involving US$1.4 billion of tariffs (ASEAN Secretariat, 2004: 17). Sensitive agricultural products follow a delayed schedule while Malaysian automobiles were exempted until 2005 when they became subject to AFTA tariff reduction schedules. Moreover, the extended deadlines have helped maintain the participation of ASEAN's newest members: Vietnam, Laos, Myanmar and Cambodia. Yet, AFTA has had a limited impact on intra-ASEAN trade, which rose to about 25% of ASEAN's total trade in 2002 from the pre-AFTA average level of 20%.[27] Absolute levels of regional trade have grown, however. On the other hand, investor interest in the newly emerging single Southeast Asian market had already increased by the late-1990s (Baldwin, 1997; ASEAN Secretariat, 1999).[28] Regional production networks are now prominent in electronic and electrical products, telecommunications equipment, automobiles and food manufacturing (ASEAN Secretariat, 1999: 16; Felker, 2004).[29] The growing, albeit limited, regional division of labour is also reflected in the growing proportion of intra-industry trade within the region. Trade in intermediate inputs now accounts for a growing proportion of total intra-ASEAN trade, especially in the all-important electrical, electronics and telecommunications equipment sectors, which together account for 45 percent of total intra-ASEAN trade (Rajan, 2004). Recent studies reveal a high degree of regional integration in these sectors with AFTA cited as one factor that explains this trend (Austria, 2004: xxxiv).

Yet, many regional businesses did not take advantage of AFTA tariff preferences due to the high administrative costs of doing so. It has been reported that only about 5% of regional trade in the 1990s made use of CEPT preferences. Market fragmentation remains a problem due to differences in domestic business regulations, divergent product standards and weaknesses in customs clearance (Tongzon, 2005). Consequently, ASEAN's aim to offer investors a single regional market as an alternative regional production site to China was only partially realised by the time the first phase of AFTA was completed. Business groups continued to face difficulties in trading and investing in the ASEAN region despite the fall

[27] Intra-ASEAN trade has, however, grown slightly faster than ASEAN's trade with the rest of the world.

[28] See also *The Sunday Times*, 'Are Japanese businesses leaving for China?', 15 September 2002.

[29] Lim (2008: 316), however, points out that many Japanese-led production networks in Southeast Asia involve linkages between the parent Japanese firm and its local affiliates rather than with "indigenous" Southeast Asian firms.

in intra-ASEAN tariffs. As a result, the US-ASEAN Business Council and the ASEAN Business Advisory Council began lobbying ASEAN members to hasten the process of deep integration (US-ASEAN Business Council, 2004). Moreover, a 2003 study commissioned by ASEAN and conducted by the private consulting firm, McKinsey, revealed that ASEAN's low labour cost advantage had already been lost to China, which had also overtaken ASEAN as an attractive location for FDI (Schwartz and Villinger, 2004). The McKinsey study also noted that ASEAN could regain its competitiveness by turning into an integrated, regional market and production base. ASEAN's answer was the AEC adopted in 2003. The ASEAN governments hoped not only to use the prospect of a "seamless" integrated regional market as a carrot to attract FDI to the region, they also intended leveraging on the region's potential as a consumer market (based on its half a billion population) and its range of internal complementarities to position the region as an internationally competitive production base and market (Hew, 2007a: 3).

4. The AEC and Regional Market Creation: Back to the Future?

The ASEAN Economic Community (AEC) project in 2003 was, therefore, driven by the same FDI logic that drove regional market creation under AFTA. However, the AEC exercise has proved to be somewhat different from AFTA in one respect. Aside from its broader scope and its explicit commitment to economic integration, it has also involved establishing from the outset, plans, timelines and targets to realize its goal, unlike the AFTA experience. A High-Level Task Force (HLTF) was set up immediately to identify initiatives to begin the integration process, and its recommendations consolidated into the six-year Vientiane Action Plan (2004-2010). In 2007, an AEC Blueprint was adopted, which identified 17 'core elements' or policy aims and 176 priority actions all to be completed within four implementation periods beginning in 2008 and ending in 2015 (ASEAN, 2008; Soesastro, 2008: 34-35). (See also Table 2). Although the Blueprint is a binding document, there are still areas where more detailed national action plans need to be worked out. More significant, its support of flexible implementation suggests that the Blueprint's potential to deliver an integrated, single regional market may be undermined by officially sanctioned departures from regional commitments, notwithstanding the Blueprint's emphasis on 'pre-arranged flexibility' (ASEAN, 2007a: 36).

All these pronouncements and action plans since the AEC was initiated have focused on at least seven, interrelated, areas for immediate action:

- Fast-track integration of 12 priority sectors that have the best potential to tap intra-regional complementarities and enhance intra-regional trade[30]
- Removal of non-tariff barriers (NTBs)
- Services and investment liberalization
- Creation of an environment of fair competition in ASEAN through national competition policies operating within regional and international best practice guidelines
- Trade facilitation, particularly customs harmonization and clearance
- Improvement and transparency in rules of origins (ROOs)
- Enhanced ASEAN Dispute Settlement Mechanism to make it less political and more effective

Although these measures had already been identified by the HLTF in 2004 and institutionalized in the VAP, progress on many of these items after four years remains limited. Although external competitive pressures had driven ASEAN leaders and policymakers to ratchet up regional collaboration towards deep integration by 2015, the intrusion of domestic distributive politics of the form that plagued AFTA has also resulted in hesitant moves by member governments on making good on AEC targets and action plans. Unlike during AFTA, however, there is now a greater degree of business interest in regional integration, partly the result of more firms participating in trade and investment within ASEAN and partly the result of the growth of regional production networks whose efficient operation relies on having a seamless integrated production space through which to move inputs and products. Nonetheless, there remain politically important domestic interests that need to be protected from regional integration. Overcoming these domestic pressures against integration would require far-reaching economic and political reforms that may be politically difficult for governments to contemplate at present and will take time to take effect even if reforms are immediately adopted. It is for this reason that the AEC is committed to flexibility in implementation by opting for inter-governmental mechanisms in monitoring and dispute settlement that allow for regional bargaining in ways that supranational or third-party, non-discretionary institutional mechanisms do not.

[30] These 12 priority sectors are: agro-based products, automotives, e-ASEAN (information and communications technology), electronics, fisheries, healthcare products, textiles and apparel, wood-based products, rubber-based products, tourism, air travel, and logistics (Hew, 2007a: 4).

The Domestic Logic of Non-Tariff Barriers

The case of NTBs illustrates very clearly how national commitments to regional integration remain hostage to domestic political logics. Despite making an explicit commitment in 2004 to address the NTB problem, the economic ministers of ASEAN in 2008 once again have had to "re-emphasize the importance of eliminating NTBs" while noting only that work has been on-going to identify those "that pose prohibitive barriers to trade for elimination" (AEM, 2008). This is worrying given that at the start of the AEC project, ASEAN policymakers had already recognized the substantial barriers posed by NTBs to forming an integrated regional market. The HLTF had also set out a number of recommendations to address the NTB problem in ASEAN, calling for the establishment of an ASEAN Database on NTBs as a first step in identifying the extent and nature of NTBs in the region (Austria, 2009: 22). The Roadmap for ASEAN Integration that had been adopted in 2006 to chart the way forward for integration of the [then] 11 priority sectors also stipulated that NTBs in these sectors were to be eliminated by 2010 by five of the six original ASEAN member states, 2012 by the Philippines, and 2015/2018 by Cambodia, Laos, Myanmar and Vietnam. These timelines have been endorsed by the AEC Blueprint (ASEAN, 2008: 5). NTBs have also been categorized into three groups for easier, staged implementation. To be immediately eliminated are NTBs that are deemed to be 'unjustifiable and unnecessary", defined as measures that are non-transparent, discriminatory in application, without any scientific backing for their use and where other less restrictive measures were available. Elimination of other NTBs would be subject to negotiation. Yet, progress on eliminating unjustifiable NTBs remains limited although ASEAN policymakers had recognized their adverse impact on ASEAN integration and despite adopting plans to do so as early as 2006 (Findlay et al, 2007: 123-23). The most common NTBs are non-automatic licensing, technical regulations, and imposed testing and inspection, which have posed significant barriers to intra-regional trade.

It is because of NTBs that CEPT utilization rates remain low, although bureaucratic difficulties and delays as well as the cost of obtaining the certificate of origin also hinder CEPT utilisation (Findlay et al, 2007: 122). Even when CEPT tariff rates differ from MFN rates by a wide margin, intra-ASEAN trade and utilization of CEPT preferences in the sectors identified as priority sectors for accelerated integration have been low due to the presence of NTBs (De Dios, 2007). In fact, not only are NTBs still present, their incidence has reportedly been rising and some have become even more complex (Austria, 2009: 16). No new notifications have been made to the 2004 ASEAN Database on NTBs, however. Moreover, later surveys of the business sector have revealed that besides traditional NTBs, other barriers to internal trade in ASEAN are also prevalent. These include quotas, internal taxes and stipulations that traders use government-sanctioned insurance and shipping firms. These, however, have not made it to the ASEAN database, which is derived from official notifications of NTBs and does not include notifications by firms that have experienced these impediments in the course of their business operations (Findlay et al, 2007: 123). Another serious barrier is posed by 'unofficial fees' that are paid by firms to expedite customs procedures and clearance as well as licensing approvals and renewals (Findlay et al, 2007: 122; Austria, 2009: 26). However, this impediment is unlikely to be recorded in the official NTB database because it not a barrier posed by official government policy or regulation; it is also politically contentious as it essentially refers to corruption that is prevalent in a good number of ASEAN states.

Identifying and eliminating NTBs is a far more difficult task administratively than removing tariffs. They are complex in nature, often involving multiple agencies, while they can take on many different forms. But, they remain attractive instruments to protect politically important domestic firms and sectors when tariffs are no longer available. A case in point is Malaysian automobiles. Malaysia negotiated a delayed tariff reduction schedule for automobiles, with tariffs coming down to 20% in 2004 and 5% in 2008, a sharp reduction from levels as high as 150-300%. When protective tariffs were removed, the domestic market share of Proton, one of the two Malaysian national car companies, immediately plunged from 49% to about 38% in 2004. However, following the first set of CEPT tariff reductions, automobile tariffs in Malaysia were replaced by a substantial increase in excise duty in a move clearly to shelter Proton (Lim, 2008: 314). Malaysia then offered exemptions on these excise duties for selected automobile manufacturers depending on the size of their investment in the country.[31] Which company was provided with these exemptions has not been revealed although the national car companies are likely to have been accorded these exemptions. Another NTB in Malaysia that restricts automobile trade is the requirement for approved permits to import completely built-up automobiles. These permits are selectively, and with little transparency, allocated to *Bumiputera*-owned companies as part of Malaysia's official policy to nurture ethnic Malay entrepreneurs.[32] Like Malaysia, other ASEAN states also resort to NTBs to protect domestic firms. Despite its commitment to an open economic regime, Indonesia, for instance, has increased the use of NTBs that are both opaque and subjectively applied, including licensing arrangements, which may be used to shelter domestic industries (ACCI, 2007).

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[31] *The Economist*, 'Proton bomb', 6 May 2004.

[32] *Daily Express*, 'Dr M defends Mahaleel: again slaps APs', 6 July 2005.

Progress on eliminating NTBs will be difficult to achieve despite recognition by ASEAN policymakers that such a move is crucial to integrating ASEAN. Not only are NTBs administratively more difficult to remove, they are also politically difficult to eliminate because of their potential value in shielding politically important domestic sectors and firms. Similar domestic logics are expected to limit rapid progress on services and investment liberalization, again despite official recognition that integration is vital to the region's competitiveness. For instance, despite the adoption of domestic reforms in its financial sector, Malaysia continues to restrict foreign participation in the financial services sector for two reasons: to increase the share of *Bumiputera*/Malay equity in this sector in line with the *Bumiputera*/Malay affirmative action programme aimed at enhancing Malay participation in and control of valuable sectors of the economy, as well as more generally to enhance the growth of domestic providers of financial services (Sivalingam, 2008: 398). In short, despite ASEAN recognition of the value of regional integration, the ambitious commitments that have been made and the adoption of action plans such as the AEC Blueprint, domestic political imperatives continue to undermine progress towards integration.

Institutional innovations: prospects for aiding implementation

One way to facilitate implementation of the AEC is through enhancing ASEAN's institutional processes to ensure effective monitoring of compliance, provide credible dispute settlement processes and develop mechanisms that punish violators. Although ASEAN has always preferred informal institutions, minimal rules and consensus decision-making that permit members considerable flexibility in making and implementing their commitments, member states were already ratcheting up the degree of institutionalization of ASEAN economic cooperation during the time of AFTA. Member states were clearly not averse to strengthening institutions and chose to deviate, even if only in limited fashion, from ASEAN's sovereignty-centric norms and practices when they recognised that failure to cooperate on AFTA could undermine the prospects for economic growth (Nesadurai, 2008: 227). As with AFTA, the AEC is now recognised as a means to help the ASEAN states collectively position themselves as a regional production hub in the global division of labour. Although ASEAN continues to privilege decentralised modes of governance in virtually all other areas of cooperation, maintaining sovereignty/non-interference as a cardinal principle for the organization, further institutional strengthening has been seen in matters relating to regional economic integration. ASEAN policymakers recognised that completing the AEC would be a politically more difficult task compared to AFTA given the AEC's ambitious deep integration agenda. ASEAN, consequently, adopted four institutional innovations to facilitate implementation of the AEC.

First, a legal unit was established in the Secretariat to provide legal advice to member states and firms on disputes arising from the AEC. Second, the ASEAN Consultation to Solve Trade and Investment Issues (ACT) was set up to resolve complaints on AEC-related operational problems within 30 days. The ACT allows private firms to link up with national AFTA bodies and achieve speedy, but non-legal and non-binding, resolutions to operational problems. Third, the ASEAN Compliance Body (ACB) was established to provide mediation services for resolving disputes. These mechanisms are modelled on existing mechanisms in the WTO and the EU; they provide rulings on trade disputes that are non-binding (AEM, 2004). Fourth, an enhanced dispute settlement mechanism (DSM) was established in 2004, which provides clear time schedules for the resolution of disputes as well as establishes panels to decide on disputes, including an Appellate Body to hear appeals on panel decisions. The Appellate Body will comprise independent (non-officials) professionals of any nationality provided they "demonstrate an expertise in law, international trade or in a field relevant to the dispute" (ASEAN, 2004). These are significant institutional changes, all 'firsts' for ASEAN. The ASEAN Charter adopted in 2007 provides further institutional support for AEC implementation by allowing for departures from consensus decision-making, with Article 20 mandating the ASEAN Summit of leaders to decide what form of decision-making to adopt in the event a consensus cannot be reached (ASEAN, 2007b).

It remains to be seen whether these institutional improvements will be able to ensure that AEC targets are met since completion of the project is some years away. More than that, there is an underlying commitment to what are ultimately political solutions to implementation problems, seen most clearly in the enhanced DSM, which retains a strong role for the ASEAN Senior Economic Officials Meeting (SEOM) in the dispute settlement process. More fundamentally, and despite claims that it signals ASEAN's 'coming of age ... as a rules-based' body (Pitsuwan, 2009), the ASEAN Charter retains a strong element of political discretion in how rules are applied and disputes addressed (Hsu, 2008: 75-78). For instance, Article 26 mandates that any unresolved dispute may be referred to the ASEAN Summit of leaders for its final decision while Article 27 stipulates that non-compliance with ASEAN's DSM rulings can also be referred to the Summit for a final decision. Thus, even having clear rules and an enhanced DSM does not preclude AEC implementation problems from being addressed through political negotiations rather than legal principles and third-party involvement. Moreover, the Charter does not provide for the use of sanctions in the event of non-compliance, raising questions of the kinds of disincentives provided in ASEAN against non-compliance with ASEAN agreements, including the AEC (Hsu, 2008: 78). In addition, the emphasis on flexibility in the AEC Blueprint (pre-arranged flexibility) and in the ASEAN Charter (Article 21), both of which endorse the ASEAN-X formula, can have mixed effects. As with AFTA, flexible methods of implementing AEC commitments can be useful in allowing governments time to institute domestic reforms and rework domestic bargains to allow implementation to proceed, albeit at a delayed pace. On the other hand, even if the delayed commitments of the excluded, 'X', members are clearly documented, an ASEAN-X formula does not help reduce the already fragmented nature of the ASEAN regional market; it could even exacerbate fragmentation.

5. Conclusion

This paper has focused on examining the prospects for ASEAN economic integration by drawing on ASEAN's historical experience with earlier phases of economic cooperation. This is not to suggest that history will repeat itself; instead, the aim was to unpack the notion of "lack of political will", which has been the usual way to explain the problematic nature of ASEAN economic cooperation. In this paper, the emphasis has been to explain why ASEAN member governments have been ready to make significant commitments on regional liberalization and integration, but then fail to implement these same commitments. A second task was to explore whether similar dynamics operate in ASEAN's current project on regional economic integration.

The analysis shows that domestic political economy imperatives continue to pose problems for regional integration through the AEC. In general, ASEAN governments continue to be preoccupied with securing the interests and position of selected domestic firms, industry sectors, socio-economic groups as well as other broad-based social, including ethnic, groups, depending largely on the prevailing nature of relations between political elites and domestic society as well as the nature of the domestic political economy more broadly. Thus, in some settings, governments remain committed to a broadly realist/nationalist agenda of empowering the state or subscribe to a developmentalist agenda of creating high performing domestic/national firms. In other instances, fractions of domestic capital are privileged because these are closely allied to political elites or because of other socio-political bargains. In all these cases, governments achieve these goals through selectively allocating economic benefits to these privileged groups. In the process, however, their commitment to regional integration becomes compromised despite its perceived utility in enhancing the competitive position of the region. Although implementation of regional integration commitments can be undermined by weak state capacity arising from limited financial, technical or administrative resources, this problem is easier to address than implementation setbacks arising from domestic distributive conflicts, which are highly politically charged.

Although domestic liberalization reforms in the ASEAN states have removed many obstacles to integration compared to the time of AFTA, domestic imperatives of the sort described here remain important, as seen in the brief discussion of the case of NTBs, making uncertain the completion of ASEAN's ambitious economic integration project by 2015. Although the presence of adequate adjustment funds that can function as side payments to affected industries can help governments overcome some domestic resistance to regional integration, the fact that the ASEAN states are economic competitors adds to the problem. Malaysia, Indonesia and the Philippines are now competing not only with each other but also with the less developed states in the same sectors and on the same basis of low labour costs. Domestic reforms are clearly warranted to place individual economies on a sounder, structural footing in relation to the range of competitive pressures they face. These include reforms to enhance domestic technological capacity, education and skills, infrastructure, as well as administrative efficiency. By supporting the capacity of businesses to adjust, such reforms are also expected to enhance the confidence of business firms in facing competition, therefore, helping to reduce business resistance to integration (Findlay et al, 2007: 129). However, domestic political reforms are equally needed to embed good governance policies and principles – rule of law, transparency, and checks and balances on political power – that promote competition and discourage political elites from acting as monopolists distributing economic privileges to themselves and their supporters (see Abrami and Doner, 2008: 231). Equally important, political governance reforms can work towards reducing the incidence of corruption that has also exacerbated the problems businesses face in accessing the regional market.

That progress on commitments will take place is not in doubt as the external competitive imperative for governments to proceed on integration is in place. How fast it will proceed and whether all measures identified in the AEC Blueprint will be adopted is more uncertain. Moreover, the flexibility formula inherent in both the AEC Blueprint and the Charter, coupled with the ultimately political nature of implementation, provides room for discretionary actions by national governments. The answer may lie in reinforcing the external impulses that drove the initial commitment to regional integration such that the balance of incentives facing member governments is altered in favour of regional integration. The role of business pressure in pushing the ASEAN governments towards the integration agenda has been noted. What now needs to be done is to harness and channel business pressure more effectively towards this end. In this regard, bottom-up processes such as parallel peer reviews of ASEAN achievements on integration conducted by businesses (or conducted on businesses by academic institutions or groups like PAFTAD, for instance) in a concerted and regular fashion can help convey to member governments the urgency of implementation as well as the costs of not doing so in terms of lost business opportunities and ultimately, of the prospects for growth. It is not sufficient for businesses to be integrated in official review mechanisms or to contribute to official 'scorecards'. Separate tracking processes, including regular, institutionalised surveys of business sentiment on regional integration, including all specific instances of impediments, are needed to provide the independent source of information – and pressure – on governments to make good on their integration commitments. Given the twin political imperatives facing the ASEAN governments – between external competitive pressures and domestic political economy imperatives – one approach to ensuring that regional integration commitments are implemented may well lie in enhancing the relative strength of the former through strategic use of business pressure in favour of regional integration.

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Table 1: Four models of the globalisation-regionalism relationship

Ideal-Type Models	Relationship to Globalisation	Key Driving Force	Key Features	Relationship to Foreign- and Domestic-owned Capital
Neoliberal Regionalism [A variant of open regionalism]	Engages with globalisation	Concern with efficiency	No new barriers to non-members imposed; Full deregulatory agenda contemplated; Also associated with agenda to reduce government's role in all aspects of economic activity; Hence the neoliberal credentials.	Does not distinguish between foreign and domestic-owned capital; All globally oriented capital privileged
FDI Model [A variant of open regionalism]	Engages with globalisation	Concern with attracting FDI, which is a crucial source of growth; Efficiency may be a primary or secondary concern.	No new barriers to non-members imposed; Deregulation agenda could be extensive or limited; Ambivalent with regard to government's role in the economy; More likely to be an instance of embedded neoliberal regionalism	Foreign capital (FDI) is targeted
Resistance Model	Resists globalisation	Concern with social/ distributive issues	Seeks insulation from global market forces; Dominant agenda is social/distributive.	Other social groups, apart from capital privileged, notably labour
Developmental Regionalism	Engages globalisation eventually, though initially has a period of limited and temporary resistance to it	An initial concern with domestic distribution, with growth a long-run aim	Employs temporary protection of, or temporary privileges for domestic capital; Distribution is thus directed towards domestic capital.	Domestic capital privileged

Source: Nesadurai (2003: p. 48, Table 1.1)

Table 2: The 17 Core Elements of the ASEAN Economic Community Blueprint

	CORE ELEMENTS
A	***Single market and production base***
A1	Free flow of goods
A2	Free flow of services
A3	Free flow of investment
A4	Freer flow of capital
A5	Free flow of skilled labour
A6	Priority integration sectors
A7	Food, agriculture and forestry
B	***Competitive Economic region***
B1	Competition policy
B2	Consumer protection
B3	Intellectual property rights
B4	Infrastructure development
B5	Taxation
B6	E-Commerce
C	***Equitable Economic Development***
C1	SME development
C2	Initiative for ASEAN Integration
D	***Integration into the Global Economy***
D1	Coherent approach towards external economic relations
D2	Enhanced participation in global supply networks

Source: ASEAN (2007a)

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