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**Amelia U.  
Santos-  
Paulino**

Division for Africa,  
Least Developed  
Countries and Special  
Programmes,  
UNCTAD

amelia.santos.paulino  
@unctad.org

# The Asian Economic Integration Cooperation Agreement: lessons for economic and social development

## Abstract

This paper examines the impact of regional integration on development in the ASEAN economic community. The study presents a measure of bilateral trade balances showing that despite rapid trade expansion, imports have grown faster than exports resulting in a deterioration of the trade balances in Cambodia, Laos, Myanmar and Vietnam - the less developed members of the agreement. The analysis also throws light on ASEAN's emphasis on promoting equitable economic development between its members. The study argues that trade agreements should seek to promote coherence between country-level and regional strategies to achieve the complex and multifaceted development objectives beyond trade integration.

**Key words:** ASEAN, development gap, regional cooperation, regional integration, LDCs



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## Acknowledgements

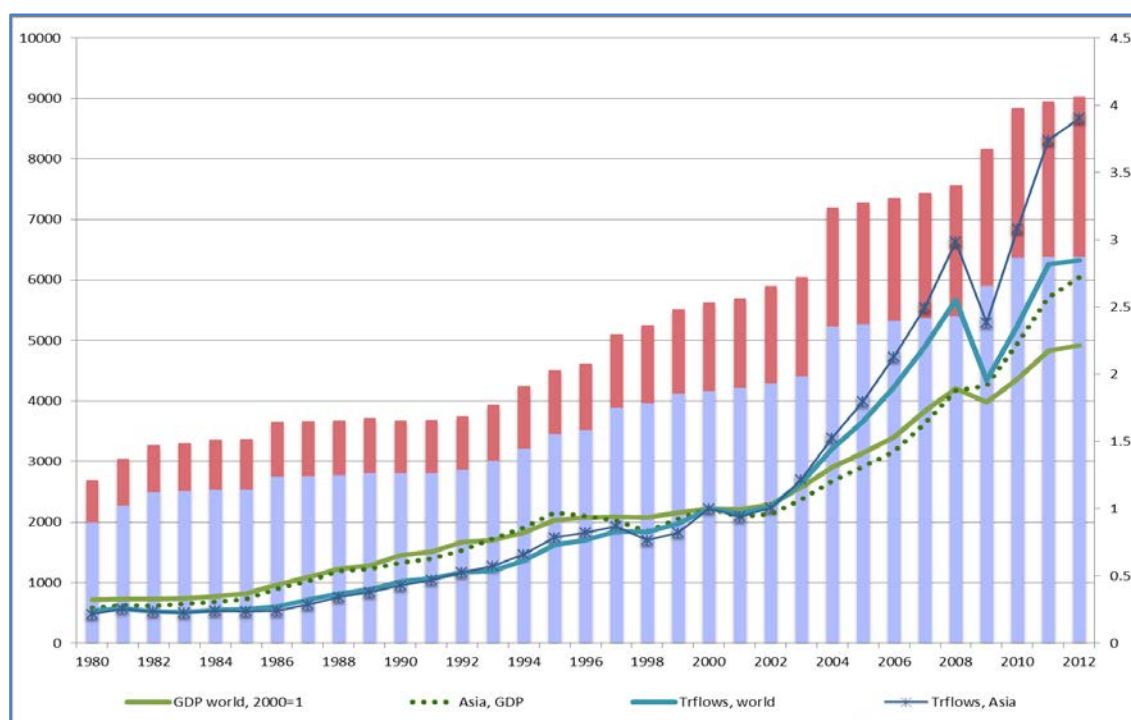
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# 1. Introduction

Global trade integration has proceeded at a fast pace since the founding of the GATT/WTO and agreements have been signed under the institution's provisions. Regional trade agreements proliferate from the 1980s in the 1990s regionalism emerged as a major driver of trade liberalization and integration both in developed and developing regions. Important agreements came into force across developing countries including ASEAN, MERCOSUR, NAFTA, COMESA, and the AECU, as well as GDP growth in developing countries, is depicted in figure 1. In figure 1, developing Asia stands out. Even if around 267 RTAs have been notified to the WTO (WTO, 2016) in reality, 1000 bilateral trade relationship pairs within RTAs are currently in place, and third of such relationships correspond to Asian agreements. The rising wave of free trade agreements trade policy instrument has led to the transformation of Asia from one of the poorest globally to 'Factory Asia' (2011). Despite rapid liberalization, whether bilateral or regional pinning down how regional integration addresses member countries' development concerns is challenging.

The paper focuses on the integration process between countries in ASEAN. It discusses the main achievements resulting from the ASEAN agreement, particularly in terms of growth, trade and investment. In addition to solid economic growth, rapid trade and investment expansion made possible by regional liberalization, ASEAN members have the important inroads in terms of structural change as compared to other developing regions. This includes a shift of productivity in tradable goods, the shift from primary products towards manufacturing and service

Figure 1. Development of Regional Trade Relationships, Total Trade and GDP the World



Source: Author's elaboration based on data from DiCapua, Santos and Sokolova (2017) and World Bank (WDI, 2016).

Note: RTA pairs (World and Asia) in the left axis (billion USD); total trade flows and GDP growth (right axis, in %).

1 The ASEAN Community comprised by the so-called ASEAN-6 (Indonesia, Malaysia, Philippines, Singapore and Thailand) and original members joined on 8th August 1967) and Brunei Darussalam (7 January 1984); and the ASEAN New Group (28 July 1995), Lao PDR and Myanmar (23 July 1997), and Cambodia (30 April 1999).

The paper also discusses challenges concerning the development by various socioeconomic indicators between ASEAN members which range from LDCs to high income economies. The implications of RTAs have been assessed in terms of market access issues while sidelining broader development implications. Yet regional integration could serve as an instrument for development by increasing trade, investment and employment. In addition to these traditional channels, regional integration can also impact poverty by encompassing regional economic projects providing infrastructure and regional public goods. Thus, the type and scope of the regional integration process may be relevant for poverty reduction.

The ASEAN Free Trade Agreement expressly emphasizes the development dimension of trade integration by addressing the inequalities amongst its members. In this context, the paper evaluates the pillars of regional integration that could impact development, and the eventual convergence of the members' development, including poverty reduction and trade diversification. In this setting, domestic policies to compensate possible negative shocks of integration are discussed (Gallagher et al, 2015).

Despite the manifest gains regionalization also brings about costs. The well-known puzzle of overlapping RTAs described by Bhagwati (1991) as 'spaghetti bowl' subsequently Baldwin's (2004) 'noodeling' to the proliferation of trade agreements. As may adversely affect the welfare and potential of regional agreements. A key challenge is harmonizing the array of barriers related to production networks prevailing in Asia, given the high interdependence of manufacturing export and import (Baldwin, 2015). Also, addressing the diverse institutional capabilities and policies in member countries. A cumbersome net of agreements is a matter of concern.

The paper proceeds as follows. Section 2 discusses ASEAN's socioeconomic development goals at the role of regional integration in addressing the development. Section 3 discusses policy implications.

## 2. Regional integration in ASEAN : progress, prospects and challenges

Research measuring the impact of regional integration in Asia conventionally focused on the effect on trade flows. Some case studies address development issues, mostly the impacts on inequality and welfare. Overall, the benefits and challenges of trade integration have been addressed through various angles and techniques highlighting both the gains and the complexities that might arise from the integration.

What Lee and Shin (2006) show that the East Asian RTAs, considered natural trading partners because of proximity and other characteristics, are likely to create more trade among members without diverting trade from non-members. Despite the magnitude of regional agreements, a number of existing and proposed RTAs also include groupings with significant countries. The current efforts toward regionalism are intended to build discriminatory blocs, which may eventually be integrated world economy, including the elimination of tariff barriers (NTBs) which is one of the pending issues in ASEAN liberalization agenda (Li and Whalley, 2004). The empirical literature agrees that the various forms of cooperation and integration in Asia, i.e. monetary and financial, trade and investment, have served to promote growth and development. There is also evidence that the partial trade agreements improves the distribution of gains across members in developing Asia (e.g. Páidín and Santos Sokolova, 2017).

Since its foundation, ASEAN has strived to become a competitive, globally integrated, economic region. Various economic cooperation and integration initiatives have provided a platform for dynamic trade and investment, allowing ASEAN to evolve into one of the world's most dynamic regions. In addition to economic

<sup>2</sup> Baldwin (2007) argues that East Asian's industrial competitiveness depends on the smooth functioning of 'Factory Asia' for intraregional trade, which is a major source of fragility to possible shocks in member countries.

<sup>3</sup> For a discussion on the effects of bilateralism vs multilateralism see, Krugman (1993), and Estevadeordal et al (2008).

progress, ASEAN's other significant achievements are in the areas of peace, prosperity, and geopolitical stability not only in Southeast Asia but through the Asia-Pacific region (Balyion et al, 2017). The AEC Blueprint adopted in 2015 develops a single and coherent plan involving clear targets and timelines for implementation taking into account ASEAN Member States' heterogeneous levels of development (see Section 3).<sup>4</sup>

Asia's RTAs represent around a third of global agreements; over 100 FTAs are in force or ratified by ASEAN and other Pacific member and more being negotiated mostly bilaterally. Similar patterns can be observed for export: 80% of intra-ASEAN trade is preferential, with over 70% of ASEAN trade at MFN zero rate and more than 90% for some bilateral agreements (ASEAN, 2016). Trade liberalisation within ASEAN has involved removing tariffs and reducing other administrative procedures in getting products to markets. In instances, the ASEAN group rates have been effectively zero since 2010.

The currently negotiated Regional Comprehensive Economic Partnership (RCEP) covers 50% of the world's population, 30% global GDP, and 25% of global exports. It aims at broadening and deepening ASEAN's engagement with its bilateral partners: the ASEAN+1 FTA formed by Australia, China, India, Japan, Republic of Korea and New Zealand. The main objective of the RCEP, from a development viewpoint, is improving the gains from participating in regional and global trade. It is also expected to help in addressing the effects of overlapping bilateral and regional FTAs between individual countries, by delivering concrete benefits through potential improvements in access, more coherent trade facilitation and regulatory rules and cooperation.

The prospects of full integration in the form of a trade bloc may represent the most important development in terms of trade agreements in the near future. However, the realization of a fully integrated ASEAN comprehensive bloc is a matter of debate (Halley, 2016). Even if it is implemented, other deep integration agreements such as the TPP, which includes 4 ASEAN countries, could be effective in facilitating freer trade, particularly for low income and least developed country members.

What follows discusses the progress made in the context of regional integration in the areas of: i) growth and poverty reduction; ii) regional integration and trade imbalances; iii) trade specialization and investment.

## 2.1 Growth and poverty reduction

Regional integration in ASEAN has played a positive role in the trade and development process. Growth in ASEAN above the average of East Asia and Pacific developing countries until 1990s as noted in figure 2. The less developed group of Cambodia, Laos, Myanmar and Timor-Leste (ASEAN4) has participated in the strong economic performance during the 1990s. Vietnam moved up from low income to lower middle income status in 2008 and Lao PDR in 2010. Laos and Myanmar are projected to graduate from the UNDS category in 2024 according to the UN's Committee for Development Policy triennial review. The notable progress in reducing poverty is depicted in figure 3.

<sup>4</sup> The joint structure for integration and cooperation, ASEAN Vision 2020 (ratified in 1997), aimed at transforming ASEAN into a prosperous and highly competitive region with equitable economic development, reduce poverty, and socio-economic disparities, progressing concurrently with the establishment of the ASEAN Political Security Community and the ASEAN Socio-Economic Community. In the process, following agreements were ratified in 1990s: the ASEAN Free Trade Area (AFTA) covering goods, the ASEAN Framework Agreement on Services (AFAS) and the ASEAN Investment Area (AIA).

<sup>5</sup> Figure A1 presents applied tariff rates in agriculture and industries by ASEAN member states.

<sup>6</sup> In its current template, ASEAN members -Brunei, Malaysia, Singapore, and Viet Nam- are part of the TPP agreement amongst other Asia-Pacific countries like Australia, Japan and New Zealand. The agreement seeks economic integration to liberalise trade and investment and at the same time promote sustainable economic growth, reduce poverty and to raise living standards, creating new opportunities for workers and businesses, and benefiting consumers. Based on WTO rules, it has obligations to each other under other agreements (see <https://media.un.org/en/partnership/initiatives/asean-tpa-definition-asec6d50311f1b#.8719nxsrg>).

Figure2. Real GDP Per Capita in Asia and other Developing Countries

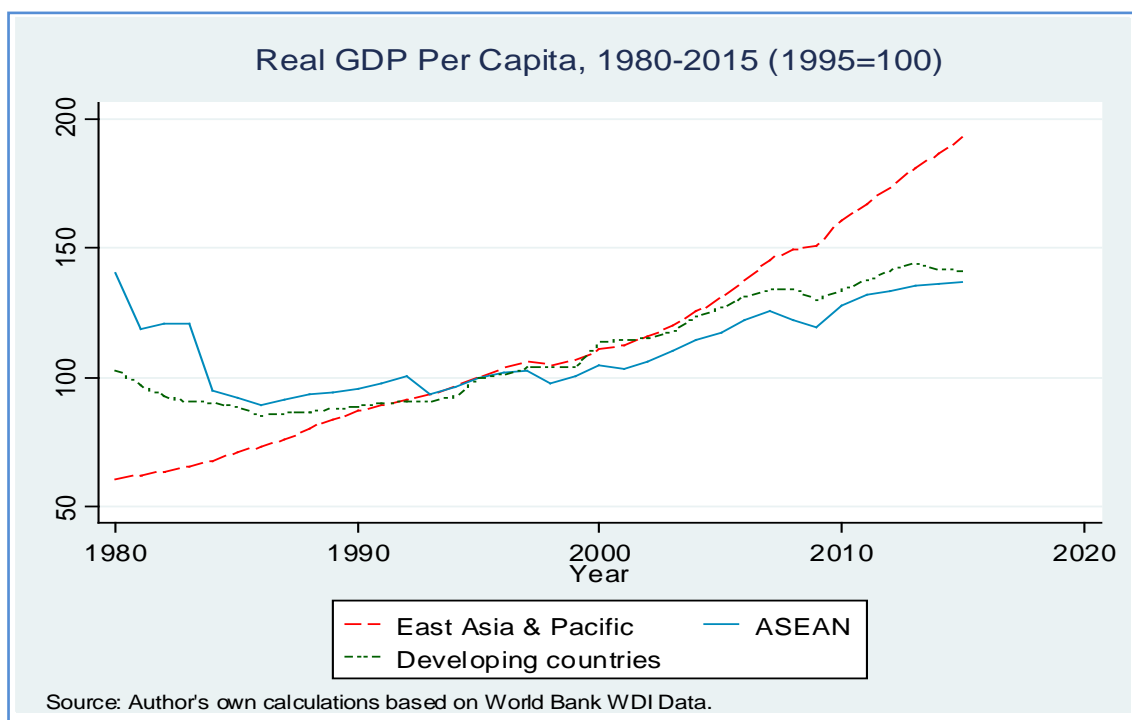
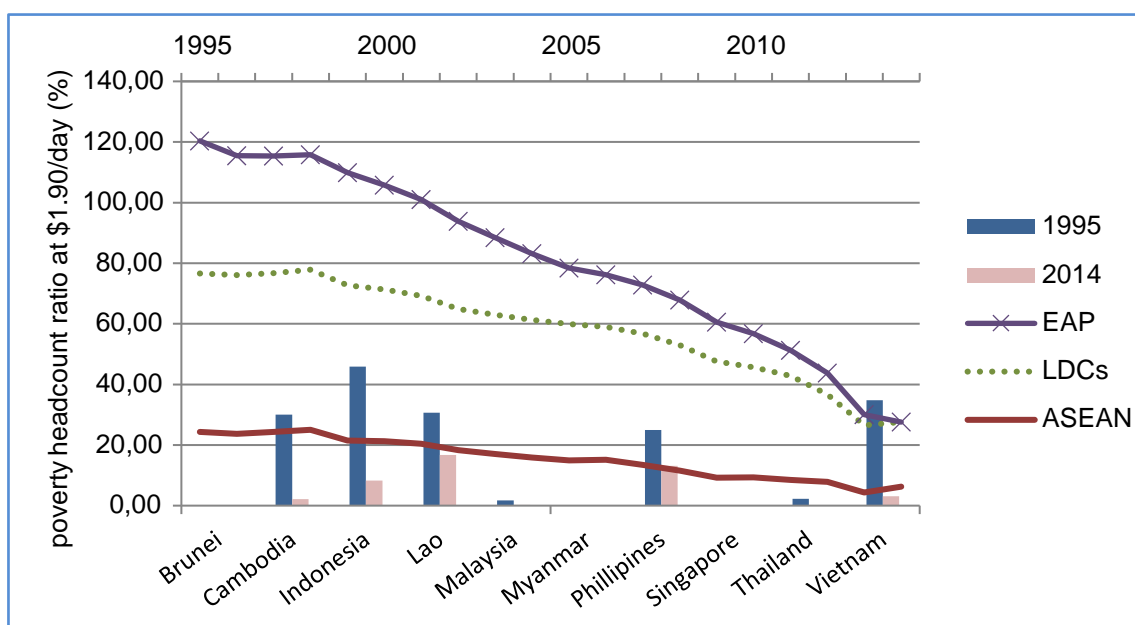


Figure 3 Poverty in Asia and other Developing Countries (1995-2014)



Source: World Development Indicators. ASEAN and Developing Countries series are author's own calculations based on WDI data.

Note: EAP refers to East Asia and Pacific. No information is available for Cambodia before 1993; for Laos and Vietnam 1984 values are used for 1980. No comparable data was available for Brunei, Singapore and Myanmar.

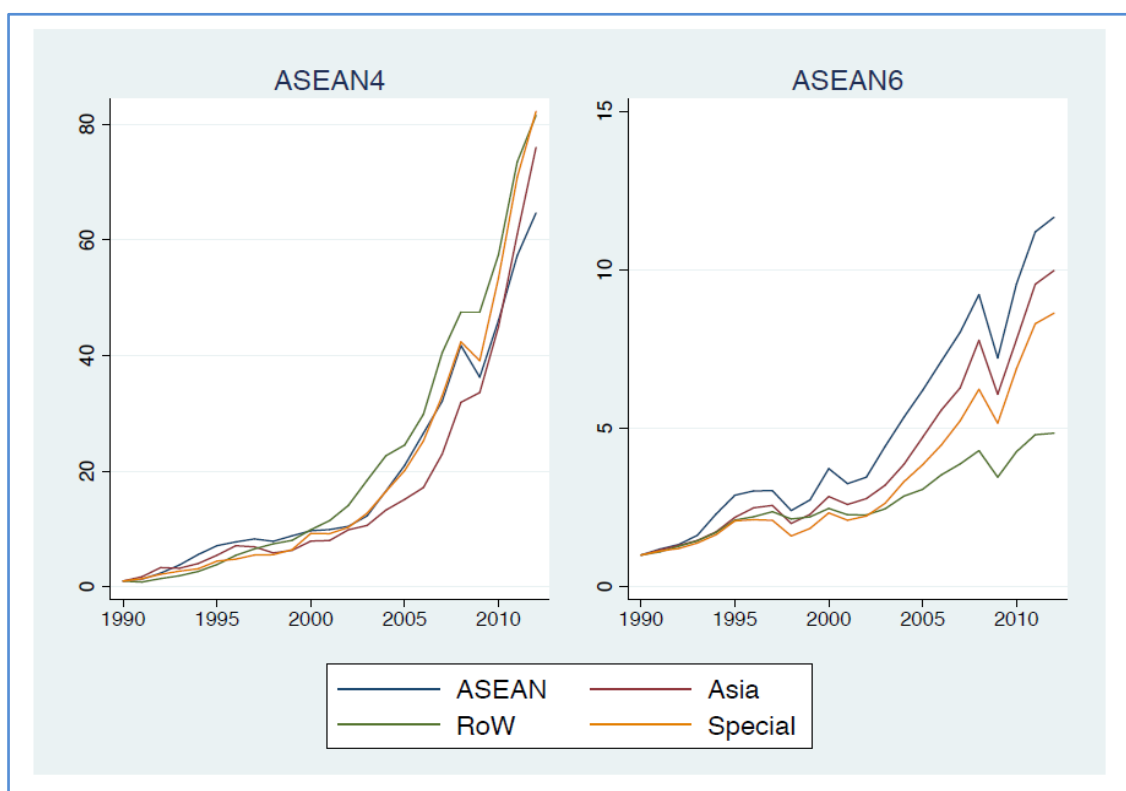


Some countries have seized growth opportunities from their natural resources endowments (e.g. Cambodia) as well as from the changing dynamics of the regional and global economy, which have allowed them to upgrade and diversify their economic structures as will be discussed later. In East Asia, greater wealth and robust growth has been accompanied by social progress, notably raising living standards and a remarkable reduction in poverty rates, in comparison to other regions and countries. In developing countries such as Cambodia and Lao poverty rates are lower than the average for LDCs as a group.<sup>7</sup> Despite progress, ASEAN countries still face challenges in terms of human and social development, and growing inequality, as observed in table A1 in the annex.

## 2.2 Regional integration and trade imbalances

Trade has been growing rapidly following ASEAN integration agreements, both within and outside the region. ASEAN is the fourth largest exporting region in the world, accounting for 7% of global exports, only behind the European Union, North America, and Oceania. The economic interdependence in the region is observed in the increasing trade flows within ASEAN and emerging partners, in relation to traditional partners. For instance, in 2015 intra-ASEAN trade represents around 25% of total trade, up from 15% in 1990. Trade with China, Japan, and Korea (see Figure 4) in the region in goods, alongside other trade flows, is also expected to increase as a result of the AEC implementation and the formation of the RCEP.

Figure 4 Bilateral trade ASEAN 4 and 6 by type of trade partner (1990=100)



Source: Author's elaboration based on data from DiCapua, Santos and Sokolova (2017).

Note: RoW = Rest of the World, Special = China, Japan and Korea. Normalised trade flows (1990 = 100).

<sup>7</sup> Figure A1 in the Appendix presents the trends for individual ASEAN countries.

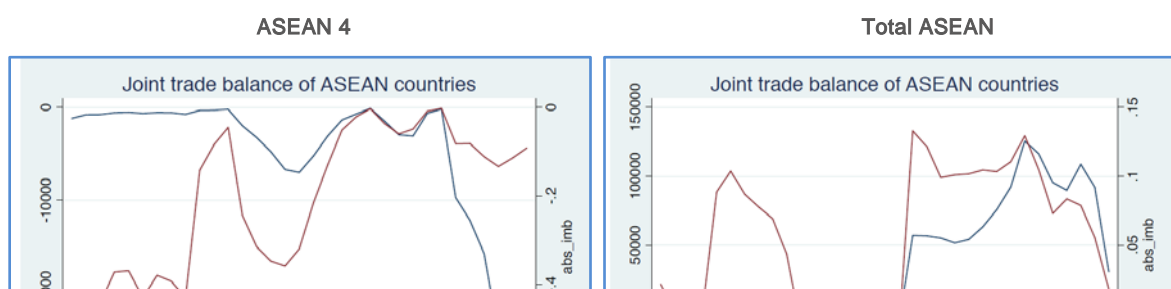
It is argued that export led growth has defined ASEAN development as three decades over and above the evolution of total trade flows, it is useful to explore regional trade by examining how exports fare in comparison to import penetration. This matters because if trade liberalisation leads to faster growth of imports than exports can have implications for the balance of payments that may constrain growth below the growth of productive potential (Santos and Thirlwall, 2004). In evaluating ASEAN trade performance and to understand the magnitude of bilateral trade balances, the study estimates bilateral trade imbalances between ASEAN and major trade partners (see De Caprio, Sarrasin and Sokolova, 2017). Absolute trade imbalance is measured as the share of exports in total trade of ASEAN4 (Cambodia, Laos, Myanmar and Vietnam) or ASEAN6, and is expressed as:

$$T_{ij} = \frac{X_{ij} - M_{ij}}{X_{ij} + M_{ij}}$$

where  $T_{ij}$  are exports of country  $i$  to country  $j$  and  $M_{ij}$  are imports of country  $i$  from country  $j$  (ASEAN4 or ASEAN6)

The index is illustrated in figure 5 showing that ASEAN as a group has gained overall in terms of trade expansion and positive trade balance. However, ASEAN 4 countries have become net importers (see also figure A2), is, Cambodia, Laos, Myanmar and Vietnam, have experienced deterioration in their trade balances due to higher imports. This can have repercussions for economic performance in developing countries that are highly dependent on export earnings as capital inflows as a source of foreign exchange. Trade deficits can harm domestic economies by affecting production and hence the labour market. Improvements in trade balances on the other hand raise income and thus savings, and reduce reliance on imported capital. This demands more research, particularly in the context of trade in integrated regional value chain activities.

Figure 5 Net Exports and Trade balance of ASEAN and ASEAN4 countries



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