

THE PROSPECTS OF ASEAN ECONOMIC COMMUNITY

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ABSTRACT

The world trading environment has changed during the last three decades, especially on the increasing tendency of regionalization. While ubiquitous regionalization is regarded as the new necessity, recent studies provide mixed views on the effectiveness of the current development of economic integration among the member countries of Association of Southeast Asian Nations (ASEAN). ASEAN regionalization has been commenced through AFTA in 1992 and recently ASEAN is moving toward further economic integration under the ASEAN Economic Community (AEC), which is planned to be implemented by 2015. Based on the characteristics of the ASEAN trade and investments, this research provides an outlook on the prospect of AEC. First, it provides picture related to the tendency of each of the ASEAN members in regard to their trading patterns. Second, it provides the outlook concerning the current structure and developmental phases of the ASEAN economies. Finally, it provides information about the gaps of development among the ASEAN economies, particularly between the ASEAN-6 and the ASEAN-CLMV.

Key words: Globalization, Regionalization, Regional Trading Agreement (RTA), ASEAN Economic Community (AEC).

PROSPEK MASYARAKAT EKONOMI ASEAN

ABSTRAK

Lingkungan perdagangan dunia telah berubah selama tiga dekade terakhir, terutama terkait dengan peningkatan kecenderungan regionalisasi. Sementara regionalisasi dianggap sebagai kebutuhan baru, studi terbaru justru memberikan pandangan yang beragam tentang efektivitas perkembangan saat integrasi ekonomi antara negara-negara anggota Perhimpunan Bangsa Bangsa Asia Tenggara (ASEAN). Regionalisasi ASEAN telah dimulai melalui AFTA pada 1992 dan dewasa ini ASEAN bergerak menuju integrasi ekonomi lebih maju di bawah ASEAN Economic Community (AEC), yang rencananya akan dilaksanakan pada 2015. Berdasarkan karakteristik dari perdagangan dan investasi ASEAN, penelitian ini memberikan pandangan tentang prospek AEC. Pertama, penelitian ini memberikan gambaran yang berkaitan dengan kecenderungan masing-masing anggota ASEAN dalam hal pola perdagangan mereka. Kedua, memberikan pandangan mengenai struktur saat ini dan fase perkembangan perekonomian ASEAN. Akhirnya, studi ini memberikan informasi tentang kesenjangan pembangunan di antara negara ASEAN, khususnya antara ASEAN-6 dan ASEAN-CLMV.

Kata Kunci: Globalization, Regionalization, Regional Trading Agreement (RTA), ASEAN Economic Community (AEC).

INTRODUCTION

The world trading environment has been changed during the last three decades, especially on the increasing tendency of regionalization. In this sense, Southeast Asian region is not differed from other regions in the world. The increase of regionalization in the Southeast Asian region can be viewed as part of the widespread tendency of regional collaboration initiatives at the global scale. Regionalization in this region, which has been taking place under the Association of Southeast Asian Nations (ASEAN), was commenced in the form of ASEAN Free Trade Agreements (AFTA) in 1992 and recently the region is working at an early phase of economic integration namely the ASEAN Economic Community (AEC). The AEC is planned to be progressively started by 2015. However, recent studies give mixed views regarding the effectiveness of AEC (Lloyd and Smith 2004; Cuyvers et al. 2005; Soesastro 2005; Hill and Menon 2010).

This research attempts to observe the prospect of the AEC. To pursue this objective, this study focuses on analyzing the characteristics of the intra- and extra-ASEAN trade as well as the intra- and extra-ASEAN inward foreign investments, which are the key issues to examine the future of economic integration in the region. In this regard, trends of some statistical figures will be compared and qualitatively inferred. To support the analysis, findings and analyzes from selected empirical studies will also be considered. The data for the analysis will be based on several publications, particularly the ASEAN's statistical figures of 1980-2008 from the ASEAN Statistical Yearbook, and the World Bank database. Some parts of the analysis will pay concern to the ASEAN-5 as the major economies in ASEAN. This is a common approach used in many studies to shed light on the pattern of the whole ASEAN economies, since the ASEAN-5 generally acts as the role model of development in the region.

This paper is arranged in the following. Section II gives discussion on the tendencies of economic globalization and regionaliza-

tion. Section III provides the background and rationale of AEC. Section IV and V discuss the characteristics of ASEAN's international trade and investments and importantly how would they contribute to the prospect of AEC. Finally, Section VI concludes with several policy recommendations.

THEORETICAL FRAMEWORK

Globalization and Regionalization

As the barriers to the cross-border movement of goods have been reduced globally, trade of goods has vastly grown together with the market of production factors, which then enable the development of international production networks. Following the development, there comes up another trend of regionalization which is the process of structuring more closely linked regional markets for goods, services and production factors in the form of Regional Trading Agreements (RTAs). In fact, the number of RTAs had been proliferated from 33 in 1994 to 204 in 2010.

There are three major factors related to the development of regionalization. First, it is the slow process of multilateral trade liberalization under the WTO. Especially, the failure of the 1999 WTO meeting began a new round of comprehensive multilateral negotiations. Second, the enlargements of the European Union (EU) and the North American Free Trade Agreement (NAFTA) have induced the proliferation of RTAs in the rest of the world. Theoretically, this development of RTAs can also be explained by the gravity model of trade. The model predicts that bilateral trade flows depends on economic size and distance between economies. According to the model, among economies there is a tendency for those of a given size with higher incomes per capita to trade more extensively with each other than do poorer economies with the same total size. Moreover, trade declines less than proportionally with distance, which is consistent with the cost structure of transportation charges (Caves et al. 1999). Third, Asian financial crisis of 1997-98 demonstrated the need of stronger regional financial and other

macroeconomic coordination. This last factor is especially works for the East Asian economies (Harvie and Lee 2002).

Regionalization is based on the concept of preferential trading arrangements (PTAs) by which a group of economies eliminate trade restrictions among themselves while maintaining the restrictions against the rest of the world. The regional arrangements are involved economies with common borders, sharing a continent or frequently common culture and language. The supporters of RTAs suggest that the chances of gain are enlarged through the arrangements since the new common tariffs are lower than the previous individual ones, hence reducing trade diversion. Also, when economies form a common external tariff they usually opt to averaging the previous individual tariff rates, so there will be less variation among the different classes of imported commodities in the region, which is another source of lesser trade diversion.

However, looking another way, RTAs are analytically intricate since it both liberalize and distort trade. Trade is freed because some flows of goods have lower restrictions than before, but trade is also distorted because goods coming into a member country pay tariff differently depending on their origin. Because of this two-faced character, such preferences can either improve or deteriorate the economic welfare of their members or of the rest of the world. Therefore preferential trade arrangement can bring gains only when it produces additional trade creation over the trade diversion. If trade creation is likely to predominate, the involved economies should be actually competitive before the union but potentially complementary after the arrangements take effect (Viner 1950).

The preferential arrangements may involve the elimination of tariff and no tariff barriers of trade in all or nearly all goods and services among the member economies. The following are the usual classification (Caves et al. 1999):

1. Free-Trade Area, in which members

eliminate trade barriers among themselves but keep their original barriers against the outside world. For example, the North American Free Trade Agreement (NAFTA) among the United States, Mexico and Canada.

2. Custom Union, in which members not only eliminate all trade barriers among themselves but also form a common tariff against the outside world.
3. Common Market, in which members proceed beyond a customs union to eliminate restrictions on movements of factors of production among themselves. For example, the European Union (EU) in 1993.
4. Economic Union, in which members proceed beyond a common market to unify their fiscal, monetary and other socio-economic policies. For examples, Belgium and Luxembourg which together formed an economic union in 1921.

The classification is arranged according to their proximities toward the concept of economic integration that aims to form a single market. By definition, a single market is an area in which there is no discrimination in the markets for commodities and production factors against the same foreign goods, services or capital and labor. That is there is a single price in the region-wide market for every tradable commodity and factor, with all prices are expressed in a single currency and the real costs of moving commodities or factors between locations are adjusted. The reasoning behind economic integration is to increase the productivity of factors in the regional economy.

EU so far has completed the elimination of all border measures in all markets and almost all the beyond-border and cross-border measures; and in 2002 has also applied a single currency. Other RTAs like Australia-New Zealand Closer Economic Relation (CER) and North-America Free Trade Agreements (NAFTA) are ranked after EU in term of their general progress toward the integration of the member economies, whereas ASEAN and MERCOSUR are the least integrated.

Table 1
ASEAN Economies: Income Level, 2003-2008

Country	GNI per Capita at Current Market Price USD						Income Level
	2003	2004	2005	2006	2007	2008	
ASEAN-5							
Indonesia	930	1,120	1,260	1,420	1,660	2,010	Lower-middle
Malaysia	4,160	4,740	5,200	5,720	6,400	7,250	Upper-Middle
Philippines	980	1,080	1,160	1,250	1,460	1,700	Lower-middle
Singapore	22,650	25,180	28,340	31,380	34,640	37,650	High
Thailand	2,060	2,360	2,580	2,860	3,240	3,670	Lower-middle
ASEAN-BCLMV							
Brunei Darussalam	17,690	19,810	22,770	27,050	-	-	High
Cambodia	340	390	450	500	560	630	Low
Laos	340	400	450	510	610	750	Low
Myanmar	-	-	-	-	-	-	-
Vietnam	470	540	620	690	780	910	Low

Source: World Bank database.

RESEARCH METHOD

This research provides an outlook on the prospect of AEC based on the characteristics of the ASEAN trade and investments. This research used secondary data from World Bank database and ASEAN Statistical Yearbook 2008.

DATA ANALYSIS AND DISCUSSION

The ASEAN Society and the Origin of ASEAN Economic Community

ASEAN was established on 8 August 1967 in Bangkok, with the initial five founder economies were Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The primal motivations behind the birth of ASEAN at that time were the national building after a long period of colonialization in the region, the common fear of communism, the reduced faith on foreign powers in the 1960s, as well as the aspiration for economic development, through regional cooperation. Its aims include the acceleration of economic growth, social and cultural developments, the protection of the peace and stability, and to provide opportunities for member countries in the region to discuss differences peacefully. ASEAN's membership then has expanded into ten countries, after Brunei, Cambodia, Myanmar, Laos, and Vietnam joined the society.

In 2009, ASEAN spans over an area of about three percent of the world's total land,

with a population of approximately 584 million people or 8.8 percent of the world population. It's combined nominal GDP in 2009 reached to 1.507 trillion USD, ranked as the ninth largest economy in the world. ASEAN-5 economies that refer to the five largest economies in the region have ranked into high-income and middle-income economies. In 2008, Singapore reached high-income GNI per capita of 37,650 USD, while the other ASEAN-4 categorized at middle-income level. However, Brunei Darussalam, which categorically excluded from the ASEAN-5, is having high-income GNI per capita of 36,692 USD. Table 1 describes the details.

ASEAN economies have widely been acknowledged as one of the world's most dynamic economic growth. Members of ASEAN-4 (ASEAN-5 excluding Singapore) are rich in natural resources and are major world producers of rubber, tin, copra, palm oil, petroleum, coal, and timber. In the past decades, their economic developments were largely resource-based and they were competing as exporters of primary products, both the agricultural and mineral. Since the early of 1970s they have been rapidly industrialized their economies to reduce the dependency on exports of primary products and imports of manufacture products.

In the early of 1980s, the collapse of international oil and commodity prices, the in-

ternational debt crises and the recession in the OECD economies impacted adversely the ASEAN economies. Extensive economic reforms were introduced, with the emphasis on deregulation, privatization, manufacturing export, and foreign direct investment (FDI). These efforts successfully brought recoveries and continuous growths for more than a decade, before then the economies suffered from the effects of Asian financial crisis in 1997-99. The crisis led the economies to further restructure and reform their financial systems and the economic rebounds in the region were slowly started from year 2000 and continue to grow more rapidly since 2003. However, the last global financial crises in 2008 that were affected the US and European economies, have once more slowing down the developing pace of the ASEAN economies.

Since the late of 1970s onwards, ASEAN economies have pay interests to closer economic collaboration. A PTA was agreed upon in 1977. Its impact was limited, however. The tariff concessions within PTA framework were small, or related to products that represented only a marginal proportion of intra-ASEAN trade. The cause was at that time ASEAN economies were not ready enough to open up, mainly due to the development gaps that existed between the member states and apparently by the facts that some members were wedged to import substitution strategies.

It was only in the second half of the 1980s that trade liberalization seriously started to take effect. By that endeavor, ASEAN members also wanted to prepare themselves against the developments of NAFTA and the EU. Therefore, in January 1992, ASEAN leaders decided to take their trade liberalizations to a higher level, by establishing the ASEAN Free Trade Area (AFTA). AFTA is an agreement concerning manufactures trade in all ASEAN economies. In 1995 they also concluded the supplementary ASEAN Framework Agreement on Services (AFAS) and consecutively in 1998 established the ASEAN Investment Area (AIA).

Afterward, the ASEAN Summit in October 2003 agreed to progress toward an

ASEAN Economic Community (AEC) by 2015 for the ASEAN-5 and by 2020 for the ASEAN-BCMLV. The AEC is meant to be a single market and production base, with free movement of goods, services, investment, skilled labor and a freer flow of capital; also to foster equitable economic development in the region and to reduce poverty and socio-economic disparities by the year 2020 (ASEAN Secretariat 2007).

By establishing AEC, ASEAN hope to integrate the regional markets as in the EU. However, it is important to note about the structural differences between the proposed AEC and the EU. AEC set-up will not include a common external tariff, as the individual ASEAN economies are reluctant to give up national economic policies vis-a-vis non-members. This is due to huge discrepancies between the member states in their average external tariff levels. Singapore for example, basically is a free port and does not levy import tariffs. To arrive at a common external tariff, Singapore would consequently have to start levying tariffs or the other nine ASEAN member economies would have to eliminate their tariffs. Moreover, AEC will not include the use of single currency.

It is estimated that an integrated ASEAN could increase regional GDP by at least ten percent or 50 billion USD, and reduce operational costs by up to twenty percent (ASEAN Competitiveness Study 2003). The other reasons behind AEC are to respond to the recent enlargement of the EU, which creates threat of FDI distraction (i.e. the increasing share of European FDIs flowing into their new member states rather than into ASEAN), as well as anticipating the rising competition from other low cost producers in Asia, such as China and India.

A fast track scheme has been developed to accelerate the integration under the AEC. A specific roadmaps of ASEAN Sectoral Integration Protocols have identified 11 priority sectors, i.e.: agro-based products, air travel, automotives, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparel, tourism, and wood-based

Table 2
ASEAN Economies: Trade Orientation, 2003-2008

Country	Trade to GDP Ratio (%)						Average
	2003	2004	2005	2006	2007	2008	
ASEAN-5							
Singapore	397.30	423.57	428.46	438.09	404.85	423.11	419.23
Philippines	105.19	105.51	99.30	95.24	84.80	75.56	94.27
Malaysia	194.20	210.37	212.10	210.97	200.74	-	205.68
Indonesia	53.62	59.76	63.99	56.66	54.83	58.42	57.88
Thailand	124.58	136.54	148.25	143.71	137.67	150.49	140.21
ASEAN-BCLMV							
Brunei Darussalam	105.26	100.59	97.46	97.04	95.47	-	99.16
Cambodia	123.08	134.51	136.83	144.62	138.28	-	135.46
Laos	62.52	73.13	81.90	85.02	86.61	77.10	77.71
Myanmar	0.36	0.31	-	-	-	-	0.33
Vietnam	126.95	139.02	142.90	151.77	169.64	172.96	150.54

Source: World Bank database.

products. The decision to accelerate economic integration in these particular sectors is courageous, as the 11 priority sectors together accounted for more than fifty percent of intra-ASEAN trade in 2003 (ASEAN Secretariat 2002). Import tariffs on products under the priority sectors are planned to be completely eliminated by 2007 for ASEAN-6 and by 2012 for ASEAN-CLMV. These target dates are three years earlier than the originally foreseen under the AFTA agreement.

Nonetheless, despite of the significant progresses made, there are criticisms addressed to ASEAN economic integration. First, the impacts of AFTA are mixed (Cuyvers et al. 2005). Studies of Elliot & Ikemoto (2004), Gosh & Yamarik (2002) and Cernat (2001) find that AFTA led to net trade creation, while Dee & Gali (2003) and Soloaga & Winters (2000) suggest that AFTA led to net trade diversion. Second, the pace of ASEAN economic integration and lack of effective implementation of the commitments have often been criticized, with exception to the tariff reduction schedules. Non-tariff barriers to trade in goods have not yet dismantled, including cumbersome customs procedures, diverse product standards and conformance requirements, and lack of seamless connectivity in cross-border transportation and telecommunications. Services liberalization under AFAS and investments

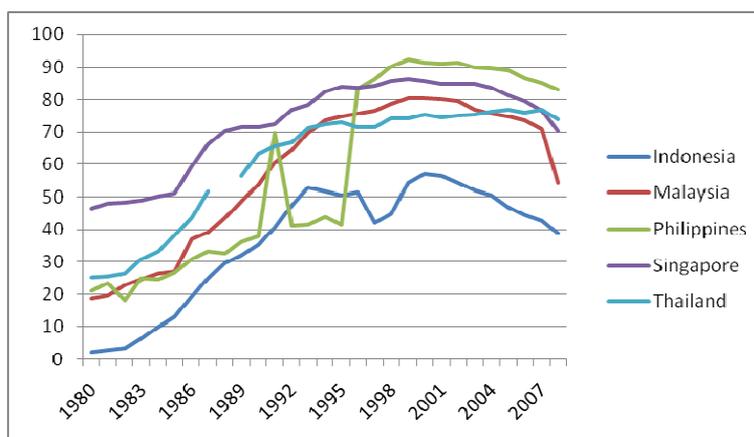
liberalization under AIA have been slow as well. As such, ASEAN is not yet a single production base in which manufacturing operations could be linked seamlessly across the region (Lloyd and Smith 2004).

The Characteristics of ASEAN Trade

This section discusses the key characteristics of ASEAN trade. The first characteristic is the high-degree of trade orientation. Trade per GDP ratios have continued to rise for most economies during the last two decades. Some of the economies were among the most trade-oriented economies in the world, i.e. Singapore and Malaysia. In 1996, Singapore's total imports and exports were more than double the size of its GDP, while Malaysia's amounted to 160 per cent. At that time, only Indonesia and Myanmar have ratios of less than 50 per cent.

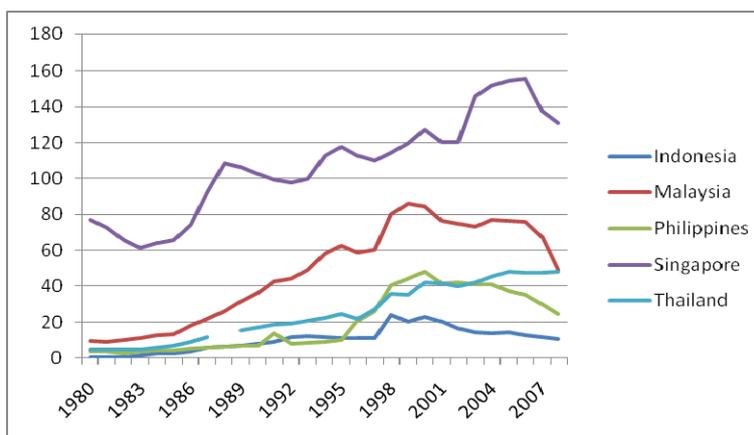
The current figure shows even higher outward-oriented profiles (see Table 2). During 2003-2008, Singapore's trade to GDP ratio was boosted at averagely 419 per cent, while Malaysia and Thailand followed at 205 per cent and 140 per cent respectively. From the ASEAN-5 only Indonesia and the Philippines which hold trade less than their GDP level, indicating their reliance on domestic markets. For the ASEAN-BCLMV, Vietnam and Cambodia were leading at averagely 150 per cent and 135 percent respec-

Graph 1
ASEAN-5: Manufacture Exports Contribution to Total Exports (%), 1980-2008



Source: World Bank database.

Graph 2
ASEAN-5: manufacture exports contribution to GDP (%), 1980-2008



Source: World Bank database.

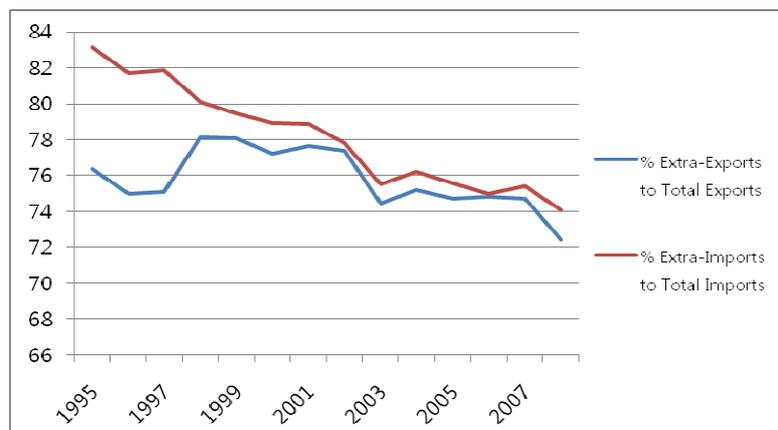
tively, while only Myanmar shown very little involvement in trade.

The second characteristic is the changing of trade composition from primary to secondary products. Back to the early times, while still mostly dependence on primary products, the ASEAN-5 economies embarked on industrialization in 1960s by the government initiatives. Similar to the newly industrialized countries' (NICs) development paths, the ASEAN-5 industrialization began with import substitution strategy with the initial focus was on final consumer goods and followed later by intermediate and capital goods. The import substitution policies were delivered through the use of tariff and non-tariff restrictions. Nonetheless, driven by the problems of inefficient import

substitution industries and the need for export earnings had led the economies to switch their policies into export promoting strategy in secondary products.

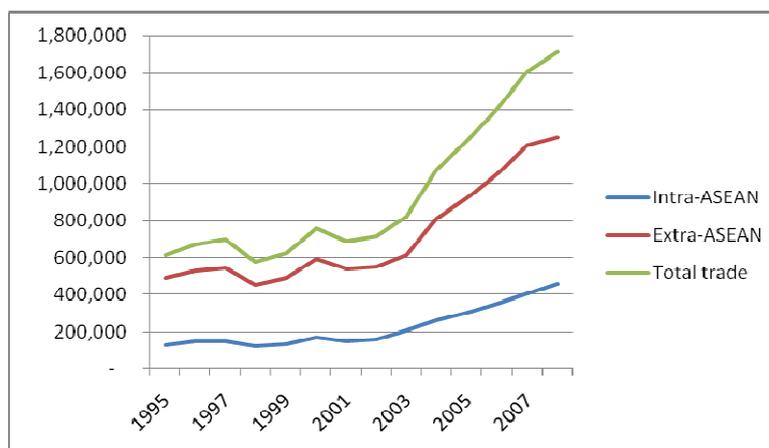
The collapse of oil and commodity prices in the early 1980s gave another force to these economies toward manufacturing exports. The export structures of ASEAN-5 then have shifted increasingly since 1980s from the traditional primary products toward more manufacturing products. Exports also have shifted from resource-based products such as processed food, beverages and wood products, toward textiles and clothing, chemicals, basic metals, machinery and electronics. In the first half of the 1990s, electronics sector, such as semiconductors, PCs, cellular phones and other telecommunication equipments, contrib-

Graph 3
ASEAN: Trends of Extra-Export and -Import (%), 1995-2008



Source: ASEAN Statistical Yearbook 2008.

Graph 4
ASEAN: Trends of Trade (Million USD), 1995-2008



Source: ASEAN Statistical Yearbook 2008.

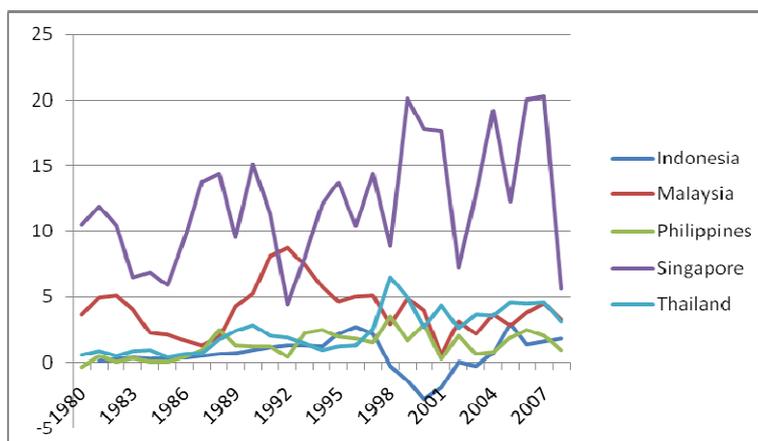
uted to the sharp growth in ASEAN exports.

The shift from import substitution to export manufacturing during 1980s-1990s is reflected strongly in the composition of exports of ASEAN-5 (in Graph 1). In 1980 primary products were dominated the exports of Indonesia, Malaysia and Thailand. By 1993, manufactures were accounted for over 50 per cent of the exports of ASEAN-5, except for the Philippines, and reaching a high of 80 per cent in Singapore. The manufacturing sectors continued to deliver higher contribution for the economies. However, it showed a declining after year 2003, especially for Indonesia and Malaysia. Accordingly, the shares of manufacturing in GDP rose rapidly for all ASEAN-5 economies, before then showed decline in three econo-

mies of Indonesia, Malaysia and Philippine, after the crisis; recently the same trend also happened to Singapore (see Graph 2).

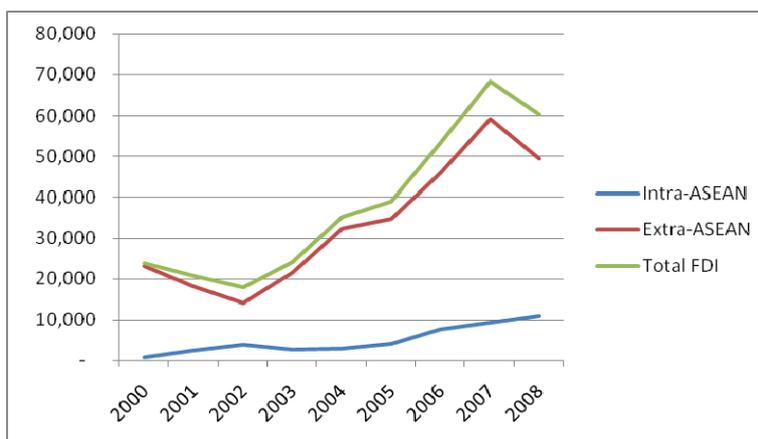
The third characteristic is that the ASEAN-5 imports and exports are largely extra-regional (see Graph 3). Their major trading partners since the last three decades are external economies of Japan, US and EU that together accounted for half of the total foreign trade. In this case, a triangular pattern of trade has emerged with ASEAN-5 importing capital goods and intermediate inputs from Japan to produce manufactures for the US and EU markets. Intra-ASEAN trade, particularly among the ASEAN-5, accounted for averagely only twenty percent of total trade during 1995-2002 and increased to averagely twenty five percent dur-

Graph 5
ASEAN-5: Trends of Net FDI Inflows as Percentage of GDP (%), 1980-2008



Source: World Bank database.

Graph 6
ASEAN: Trends of FDI Inflows (Million USD), 2000-2008



Source: ASEAN Statistical Yearbook 2008.

ing 2003-2008. Intra-industry trade in ASEAN has risen with the growth of regional component sourcing and differentiated manufactures. For example, about 60% of the total intra-ASEAN trade was comprised of intra-industry trade and the share of intra-industry trade in manufactures was higher and dominated by vertically intra-industry trade of manufactures, during 1987-96 (Hurley 2003). Singapore alone accounts for two-fifths of this intra-ASEAN trade, and trade among the ASEAN-4 (excluding Singapore) economies is considerably small. This indicates that from the export side the rest of the world is still the most important sources for ASEAN exports. From the import side, the majority of products needed by ASEAN consumers and producers are rather

supplied by the rest of the world than from the other ASEAN economies.

The third characteristic is represented in some factors. First, ASEAN economies are more competitive than complementary in structure. That is they are producing a narrow range of similar primary or resource-based products and labor-intensive manufactures for export. The intra-industry specialization and regional division of labor are not yet well-developed. Second, higher economies of scale offered by external markets of advanced economies are far more lucrative. Third, for decades intra-ASEAN trade has been hampered by the protectionist tendencies of the member economies. These factors give explanation on why ASEAN economies trade more with the rest of the world rather than among

themselves despite the lowering of tariff rates and the removal of non-tariff barriers (NTB) enjoyed by the member economies.

An important integration indicator is the trends of development in extra-export and -import as a percentage of respectively total ASEAN-exports and -imports. These indicators measure the relative importance of internal ASEAN market. As shown in Graph 3, the share of extra-ASEAN exports in total ASEAN exports first went up from 76% in 1995 to 78% in 1999, but then subsequently went down to 72% in 2008. Similar trend took place in extra-ASEAN imports, which went down continually from 83% in 1995 to 74% in 2008. Looked from these two trends, ASEAN economies are likely to make closer integration. However, this observation is not yet conclusive since during the period reviewed both ratios were still far above 50%. Moreover, while intra-ASEAN trade has been growing recently, intra-ASEAN trade has increased at a slower pace than the ASEAN total trade (Graph 4).

The fourth characteristic of ASEAN trade lies on the fact that while ASEAN is building stronger regional economic integration, it also has actively forging a number of external FTAs through APEC and ASEAN-CER, and with several economies of Japan, South Korea, India, and China. This is often analyzed as open regionalism (see for example Panagariya 1998). Moreover, individual ASEAN economies are forming a growing number of bilateral FTAs with external economies in the Asia Pacific and beyond. This is a dissimilar characteristic of ASEAN when compared to the EU. The existence of such overlapping external FTAs could induce each member economies of ASEAN to trade more externally than internally. If the rise of trade between ASEAN and their external partners occurs at the cost of intra-trade within ASEAN, then the relevance of AEC is indeed in question.

This concern is now increasing, for instance due to the existence of ASEAN-China FTA (ACFTA) which has taken effect since January 2010. ASEAN economies are viewing

the rise of China with a mixed sense of threat and hope. The hope is that China's economic dynamism and market of 1.3 billion consumers will become a new regional growth engine, particularly as the Japanese economic engine continues to slow down. However, there is also a sense of economic threat which arises from the sheer size of China's economy and its growing ability to flood the ASEAN markets with competitively-priced products (Wong 2006; Ravenhill 2006).

Overall, these characteristics and patterns of ASEAN trade have received little consensus on the economic grounds for the establishment of a strong regional FTA in ASEAN. While economist Paul Krugman (2003) suggested that FTAs between natural trading partners are more likely to be welfare enhancing than agreements between economies that lie scattered, ASEAN regional FTA is not a good example of a natural trading bloc since the inter-regional trade rather than intra-regional trade has largely contributed to ASEAN trade.

The Characteristics of ASEAN International Investments

One of the objectives of AEC is to promote free regional investment and freer capital flows. By deepening economic integration among the economies, ASEAN members expect to establish a region-wide production base that will attract more FDI and strengthen the existing FDI-trade nexus in the region. FDI is regarded as one of the common interests among ASEAN economies. Adjacent to bringing in huge capital flows, access to international markets, jobs and technology transfers, FDI can be instrumental in strengthening domestic institutions and creating a more business friendly environment. FDI is also the least volatile form of capital flows, making economies less susceptible to sudden stops or reversals of capital flows.

In this regard, ASEAN economies are also among the largest recipients of world's FDI in the developing world, since the region has increasingly become an important international production network. FDI in the

region have grown intra-firm trade, both between parent and affiliate and among affiliates based in ASEAN region. The magnitude and characteristics of FDI flows in the region will be discussed in this section.

FDI flows into ASEAN are closely associated with the intra-industry trade taking place in ASEAN and the wider East Asian region, and the establishment of vertically integrated production networks. This FDI-trade nexus is common in the automotive and electronics industries. By this sense, ASEAN pursues further liberalization in the region as a single investment area, which expectedly could improve its competitiveness and attract more investments. In particular, AEC expects to emphasize more regional cooperation in facilitating efficiency-seeking FDI and intensifying the region's participation in regional and international production networks.

At average, net FDI inflows as a percentage of GDP has continue to increased from 3 percent in 1980-1989 to 4.4 percent in 1990-1996, and further from 4.6 percent in 1997-2002 to 5.47 percent in 2003-2007; however went down stumblingly since 2008 due to the global financial crisis (see Graph 5). Exceptions toward the trend were happened only on the several post-periods of financial crisis of 1998-2000. The largest source of FDI is the EU with a share of 36 percent, followed by Japan with 17 percent and the US with a share of 13 percent, with manufacturing sectors received the bulk of the flows with a share of 38 percent.

The attempt to pursue more intra-ASEAN FDI flows would be determined by the raise of intra-ASEAN trade, as a consequence of the FDI-trade nexus in the region. The intra-ASEAN FDI trend has been steeped, whereas intra-regional investment flows in ASEAN has remained modest with a share of 12% of cumulative FDI inflows from 2000 to 2008 (see Graph 6), with Singapore which accounted for 64% of the cumulative flows as the top investor. Malaysia followed with a share of 21% and Indonesia with a share of 11%.

CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

The Southeast Asian economic developments have been characterized by their increasingly export-led and FDI-led development strategy. The intensive engagement with international trade and investment has enabled these economies to exploit their comparative advantages, achieve economies of scale, and open access to foreign capital, technology and other managerial skills. There are arguments explaining the potential of the AEC to boost up ASEAN economic integration for the mutual benefits of the member economies. Looking from this ideal, the AEC is relevance for the development of ASEAN economies. However, as discussed in the previous sections of this study, there are also some problems to materialize the ideal.

First, the tendency of each of the ASEAN members tends to be more extra-ASEAN oriented in regard to their trading patterns. This is actually reflecting the necessity for the economies to take the full advantage of their trading performance; with regard to the existing demands and economies of scale of the external markets. This condition is dissimilar to the other regional FTA such as NAFTA and EU, where the economies of scale of their intra-region trades are the major attraction to trade. One can also see this fact as a result of the divergence effects of ASEAN's external FTAs.

Second, looking at the current structure and developmental phases of the ASEAN economies, the economies are more competing than complementing to each other both in international trade and FDI. It is likely that ASEAN economies are still attempting to further specialize.

Third, there are gaps of development among the ASEAN economies, particularly between the ASEAN-6 and the ASEAN-CLMV. The gaps are in regards to their economic sizes, economic structures and technological developments. Therefore, the economies have different degrees of willingness and capability to open up their manufacturing, services or financial sectors. They often have to

work without clearly perceived common interest on many issues. Therefore, the relevance and thus the prospect of the AEC, at the current phase, is not convincing enough. This conclusion might sound pessimistic. In part, it is resulted from the static effect of the analysis. However, ASEAN could consider on the possible dynamic effects of economic integration. Positive dynamic effects could occur when barriers to trade are reduced and resulting in a substantial market size increase. Such dynamic effects when combined with intensified competition and increased investments could in turn create higher specializations and efficiencies in the region.

Alternatively, in the foreseeable future one can expect for the second-best effects to come. That is a limited integration of highly interrelated industries in the region, which then gradually can bring spillovers effects to the other industries. In this regard, there are some opportunities for the ASEAN economies' policy makers to take advantage from the dynamic effects. First, ASEAN economies need to maximize the linkage and impacts of the liberalization, by focusing on the facilitation and cooperation of the identified 11 priority sectors or the shortest possible list. Second, the economies also need to work together in improving the capacities of their trade and financial institutions which are the source of bottle necks and ineffective implementations of regional integration, particularly on the harmonization of non-tariff barriers and the mechanisms of dispute settlement.

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