



Counterpoint Southeast Asia

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Can the ASEAN Economic Community Succeed in a Two-Tier ASEAN?

By Denis Hew

ASEAN aims to integrate the economies of its ten member states and realise the ASEAN Economic Community (AEC) by 2025. This ambitious project will create a regional economic space that is not only highly integrated, inclusive and resilient but also plugged into the global economy through its free trade agreements and supply chains.

In our previous Counterpoint Southeast Asia [webinar](#) back in March 2023, many challenges to realise the AEC by 2025 were discussed (see also [Counterpoint Southeast Asia publication issue No.6](#)). One of the challenges identified in that webinar was how to address the wide

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Counterpoint Southeast Asia is published regularly by the Centre on Asia and Globalisation at the National University of Singapore's Lee Kuan Yew School of Public Policy. It seeks to answer major questions of strategic significance for Southeast Asia by bringing in diverse voices from around the region. Each issue will tackle one question from three different perspectives.

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economic development gap that exists among ASEAN's ten member states. This is an important strategic issue as equitable economic development is one of the main pillars of the AEC.

The development gap within the region is often referred to as a “Two-Tier ASEAN” in which there exists an economic divide between the older, more developed member states of Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand (ASEAN-6) and the newer, less developed members of Cambodia, Myanmar, Lao PDR and Viet Nam (CLMV).

According to most recent ASEAN statistics, in terms of GDP per capita, the top two richest member states are Singapore (US\$72,400) and Brunei Darussalam (US\$32,383). At the other end of the income spectrum, the GDP per capita of the poorest member states are Cambodia (US\$1,603) and Myanmar (US\$1,314).

This wide economic disparity is also reflected in other development indicators covering sectors such as education, health, human capital, as well as financial and legal infrastructures. Unlike the ASEAN-6, the CLMV are classified as “transitional” economies that are essentially making the transition from a centrally planned economic system to a more market-oriented one. In this context, a “Two-Track or Two-Speed” modality has also been adopted in ASEAN in which the CLMV are normally given more time to implement economic initiatives,

particularly those related to trade and investment liberalisation.

To narrow the economic development gap, the Initiative for ASEAN Integration (IAI) was launched in 2000. There have been a number of work plans since then with the deadline of its most recent IAI work plan (2021-2025) coinciding with the deadline of the AEC by 2025.

It is worth noting that the devastating impact of the COVID-19 global pandemic over the past few years may have made the economic gap even worse. Many economies in Southeast Asia—as well as the rest of the world—fell into deep recession during this difficult period and poverty levels rose significantly, setting back years of poverty alleviation programmes, particularly in lower income developing countries. Given that the CLMV have less financial resources at their disposal to address the pandemic, their economic recovery would have been at a slower pace than the ASEAN-6.

In the short-term, the outlook for the global economy remains uncertain due to persistently high inflation, the prolonged war in Ukraine, US-China trade tensions and other geopolitical concerns. Against this backdrop as well as the many challenges faced by the region to narrow the development gap, can the AEC succeed in a two-tier ASEAN?

The Centre on Asia and Globalisation (CAG) invited three analysts from Southeast Asia to address this pertinent question. They

presented their arguments in a webinar on May 22, 2023 (view the video [here](#)).

Jayant Menon, Senior Fellow at the ISEAS-Yusof Ishak Institute, argues that ASEAN's economic diversity can be turned into an advantage. The differences in factor endowments and factor prices among ASEAN member states have allowed global supply chains to flourish in the region, particularly in the manufacturing sector. Nevertheless, Jayant notes that the widening of ASEAN membership has the potential to either slow down the process of deepening in the AEC, or further fragment ASEAN, or both.

Jayant points out that intra-country inequality can be a threat to ASEAN's growth. He finds that the distribution of the gains from rapid economic growth in the CLMV have been uneven and income inequality within these countries has remained high or worsened. Jayant believes that this increase in polarisation is more worrying than the slow pace of economic convergence among member states.

Kaewkamol Pitakdumrongkit, Assistant Professor at the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University, finds the COVID-19 pandemic has indeed widened the development gap among ASEAN member states and the pace of the recovery process among CLMV has been relatively slower. She also finds that the latest IAI work plan's capacity-building activities are too narrowly focussed on language education.

Kaewkamol recommends that the scope of the IAI be expanded with more emphasis placed in the re-skilling and up-skilling of workers to better prepare them for the digital world. She also suggests that capacity-building activities under the IAI support micro, small and medium-sized enterprises (MSMEs) in all ASEAN member states and not just the CLMV.

Quynh Huong Nguyen, Economic Affairs Consultant at the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), takes a different perspective and finds that ASEAN is far from achieving one of the AEC's goals of "free movement of skilled labour." In fact, there is a significant shortage of skilled labour in many ASEAN member states, especially in the CLMV. Nonetheless, Quynh finds evidence of movement of skilled labour among ASEAN countries driven by the foreign direct investment (FDI) strategies of Japanese firms operating in the region. She argues that the private sector can play an important role in promoting and facilitating the free movement of labour in the region.

Jayant and Kaewkamol both agree that ASEAN also faces other serious challenges besides the development gap. For example, rising trade protectionism and domestic reform fatigue could slow down the implementation of the AEC Blueprint. Meanwhile, Quynh finds that the free movement of skilled labour is a very difficult and complex policy issue that requires mutual recognition and harmonisation of standards

in the labour market. This important AEC goal cannot be achieved without better coordination with the private sector.

Over two decades have passed since the launch of the IAI. But the economic divide among ASEAN member states remains significantly wide. This seems to indicate that the IAI workplans that have been formulated over the years have not been very effective. Hence, it will be crucial to redesign future IAI work plans to ensure that economic integration efforts like the AEC will benefit all member states and not just the few.

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Inter-country Diversity in ASEAN Is Not the Main Threat to Realising the AEC

By Jayant Menon

Intra-country inequality is the bigger challenge.

The defining characteristic of ASEAN is its diversity, in terms of its economic, political, institutional and almost every other dimension. The decision taken at the 43rd ASEAN Summit in May 2023 to admit Timor-Leste as a full observer with a roadmap to eventual membership will only add to the diversity. Does this diversity mean that ASEAN is divided? Most separate the newer, less developed members—Cambodia, Laos, Myanmar and Vietnam (CLMV)—from the older ones—Brunei, Indonesia, Malaysia, Philippines, Thailand and Singapore (ASEAN-6). This has given rise to the idea of a two-tier ASEAN. Some might even argue that there are not two but three tiers, with Singapore and Brunei in a third category as high-income countries.

Although the **development divide within ASEAN** is multi-faceted, a striking feature is differences in per capita incomes. Even after adjusting for purchasing power parity (PPP), the differences are striking. In 2000, the per capita income of Singapore in PPP (constant 2017 international dollars) terms was about 57 times that of Myanmar, 38 times that of



Cambodia, and 15 times that of Vietnam. However, by 2019, the multiples had fallen significantly with more rapid economic growth driven by trade and investment as a result of market reforms. The per capita income in Singapore was now only 22 times that in Cambodia, 20 times that in Myanmar, and 10 times that in Vietnam. Despite the impressive narrowing, the gaps remain significant. How will the diversity within ASEAN affect the ASEAN Economic Community (AEC)?

ASEAN's continuing diversity has its costs. The widening of ASEAN from five members originally to ten now, and eleven soon, has and will continue to dilute the depth and ambition of reforms. Widening has the potential to either slow the process of deepening in the AEC, or to further fragment ASEAN, or both. With the EU debates for instance, so-called "wideners" of the time such as UK Prime Minister Margaret

Thatcher were keen to use the expansion in membership to limit the extent of integration and the resultant loss of national autonomy with respect to various aspects of social and economic policy. The long and drawn-out process of reviewing Timor-Leste's application, which was made more than a decade ago in 2011, reflects this concern, following the experience with the accession of the CLMV countries. With Special and Differential Treatment, a key part of ASEAN's inclusivity credentials, a multiple tier track of the reform program has been hardwired into the system.

ASEAN's diversity can also be an advantage, however. The differences in factor endowments and factor prices have driven the growth and spread of global supply chains in the region, the backbone of its manufacturing industry. In fact, a key objective of pursuing the AEC is to support the growth and upgrading of global supply chains in ASEAN.

The AEC is a **process** and should be viewed more as a journey than a destination. Part of that process involves the upliftment of its poorer and more disadvantaged members. Rather than being a barrier towards realising the AEC, it should be an objective and an outcome of the process. This is happening, as noted earlier, with more rapid growth in the CLMV reducing per-capita income differentials. This process of economic convergence has given birth to a different problem which could pose a bigger threat to the AEC and its aspirations, however.

The distribution of the gains from rapid

growth in the CLMV have been uneven and income inequality within these countries has remained high or worsened. Inter-country differences in economic conditions are being narrowed while intra-country differences are being increased. All kinds of within-country inequities have remained stubbornly high or have increased, including rural-urban, along ethnic lines and across genders. High and/or rising income inequality can also threaten growth itself, as well as the poverty elasticity of growth. The **increase in polarisation** is more concerning than the slow pace of convergence because it can put at risk everything that has been built by threatening political, economic and social stability. This runs counter to everything that the AEC aims to achieve.

If the AEC faces difficulties, it will have more to do with reform fatigue related to the rise in protectionism and the pandemic than development gaps. That is, the AEC's problems lie elsewhere. ASEAN was **slipping behind** its timebound benchmarks to meet the targets of the AEC Blueprint by 2025 even before the COVID-19 pandemic hit in 2020. It is now quite unlikely that many of the targets set in the Blueprint will be met. Furthermore, it will be the more difficult reforms that are backloaded and left unaddressed. In other words, the low hanging fruit approach will apply, and the easy reforms will be the ones that are dealt with first. Even with these reforms, the key challenge will be implementation, however. It is often the case that domestic laws will have to be instituted or changed for implementation to proceed. This could come

up against resistance if domestic vested interests feel threatened and lobby policy makers to retain the status quo.

The current climate of rising risk and uncertainty may not be suited to difficult reforms that involve short-run adjustment costs in return for long-term gains. The post pandemic environment is also one characterised by an increase in anti-globalisation sentiment. ASEAN has not been immune from the rising tide of economic nationalism and the return of old and new forms of protectionism. When all of this is combined with the inherent flexibility that characterises ASEAN cooperation and institutional arrangements, it could give member states a pretext for non-compliance, with little or no consequences. ASEAN has a revamped dispute settlement mechanism but it has never been used as it is not the “ASEAN Way” of doing things.

These are the greater challenges that ASEAN should focus on, and addressing them will help move closer towards realising the AEC and thereby assist in narrowing the development gaps between old and new members.

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Development Gap since the COVID-19 Pandemic Has Worsened and Will Hinder Progress of the AEC

By Kaewkamol Pitakdumrongkit

The LAI needs to be expanded to re-skill and upskill the workforce for the digital world.

Over the last few years, COVID-19 has adversely affected the ASEAN Member States (AMS). The Asian Development Bank (ADB) found that in Southeast Asia the pandemic increased the number of extremely impoverished people (who live on less than US\$ 1.90 per day) by **5.4 million** in 2020. Furthermore, the ADB also found that the disease pushed an additional **4.7 million** people in Southeast Asia into extreme poverty in 2021.

The negative impact of the COVID-19 pandemic on the population has been uneven. For example, people with **lower levels of education, workers in the informal sector, women**, and minorities, experienced lower household incomes and higher debt due to the pandemic. Although the pandemic accelerated the adoption of digital technologies such as e-wallets, a digital divide exists in ASEAN. For instance, only a small segment of society has access to three advanced digital products (i.e., credit, investment, and insurance). **These individuals** were mostly men who were 21–40 years old,



lived in urban areas, and had at least a bachelor's degree or higher education. Also, **micro-, small, and medium-sized enterprises (MSMEs)** which account for 97–99 percent of all companies in the region and provide 60–80 percent of ASEAN's total employment, were behind larger corporations in terms of digitalisation. Several MSMEs, especially those in rural areas, lack even basic internet access.

In terms of economic recovery, government support matters. Countries like Indonesia, Malaysia, the Philippines, and Singapore enjoyed strong fiscal support, which figured at around **15–41 percent** of GDP in 2020. Comparatively, other AMS had much lower fiscal stimulus, on average less than **10 percent** of their 2020 GDP. As a result, the former group was able to recover faster. In 2021, **Indonesia, Malaysia, the Philippines and Singapore** experienced economic growths of 3.7 percent, 3.1 percent, 7.2 percent

and 5.7 percent, respectively. These figures were either equal to, or above the ASEAN average of 3.1 percent.

Interestingly, Cambodia, Laos, Myanmar, and Vietnam (CLMV) suffered less from the pandemic than other AMS in 2020. However, they recovered at a slower pace than their ASEAN peers due to factors such as limited fiscal support and/or vaccination access. Economic growth of the CLMV registered at 3.0 percent, 2.1 percent, -17.9 percent, and 2.6 percent in 2021—all below the ASEAN region's average. Thus, the evidence suggest that the pandemic has widened the development gap among AMS as reflected by the different speeds of their economic recovery.

Despite the knee-jerk reactions of some AMS (e.g., export restrictions on essential goods) at the onset of COVID-19, ASEAN was among the first international organisations to garner collective responses to the pandemic. Its leaders adopted the ASEAN Comprehensive Recovery Framework (ACRF) at the 37th ASEAN Summit in November 2020. ACRF, which **“serves as the consolidated exit strategy”** from the crisis, pursues five broad strategies: (1) bolstering the health system; (2) enhancing human security; (3) maximising the potential of the intra-ASEAN market and broader economic integration; (4) accelerating inclusive digital transformation; and (5) charting towards a more sustainable and resilient future. The ACRF Implementation Plan contains several measures aimed at galvanising supply chain

resilience, promoting a digital economy and sustainable infrastructure, and exploring the development of the ASEAN SME Recovery Facility which is a financing facility to accelerate the recovery of small- and medium-sized firms.

Also, ten AMS and five ASEAN Dialogue Partners (DPs) signed the Regional Comprehensive Economic Partnership (RCEP) at the 4th RCEP Summit in November 2020. The world's largest free trade agreement (FTA) entered into force in January 2022. Greater trade liberalisation through the RCEP can be considered one of the approaches for ASEAN to expedite post-COVID-19 economic recovery and resilience.

The worsening development gap observed since the pandemic will hinder the progress of the ASEAN Economic Community 2025 (AEC 2025). The Mid-Term Review of the AEC Blueprint 2025 (MTR) which assessed the implementation of AEC found that initiatives to narrow the development gap in ASEAN made the least headway. The report found that these initiatives remain limited to the promotion of inclusive business practices and was partially supported through the implementation of the Initiative for ASEAN Integration (IAI) work plans.

So, where do we go from here? How can we close the development gap and accelerate the implementation of AEC 2025? Several policies can be considered. First, the **IAI Work Plan IV (2021-2025)** focuses mostly on capacity-training for the CLMV countries.

However, of the 67 projects listed, 27 (around 40 percent) are about education, mainly the teaching of English. Thus, the IAI's scope should be expanded and more emphasis placed on re-skilling and up-skilling of workers. This will not only close the development gap and help CLMV countries pursue their post-pandemic recovery, but will also better prepare their workforce for a rapidly digitalising world.

Also, more assistance programmes are needed beyond the IAI scheme, which focuses on CLMV countries. According to the current IAI Work Plan, only six programmes are aimed at capacity-building to support MSMEs in the CLMV. To complement the IAI, AMS and ASEAN DPs should develop additional capacity-building initiatives to help MSMEs in non-CLMV countries. This could include programmes like helping MSMEs across the region digitise their businesses.

The [ASEAN SME Academy](#) is a private-public partnership project offering free online courses for MSMEs. This is a commendable project. However, an overwhelming majority of these modules are in English. Therefore, to enhance its ability to empower these firms, the Academy should offer courses in ASEAN languages.

COVID-19 is not the only factor that can impede the progress of the AEC 2025 going forward. Some other factors like the intensifying US-China competition and the

war in Ukraine have created uncertainties and downside risks to the outlook for the global economy. These geopolitical concerns could feed into government policy decision-making. For example, policymakers may begin to think of supply chains more from a security angle rather than from an economic or business perspective. There are also concerns of rising trade protectionism and other protectionist measures being implemented by individual governments to address domestic problems. Against this challenging environment, the success of AEC 2025 and future post-2025 regional integration efforts remains to be seen.

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ASEAN Free Movement of Skilled Labour and the Role of the Private Sector

By Quynh Huong Nguyen

A complex policy issue that requires mutual recognition and harmonization of standards in the labour market.

In 2003, the Association of Southeast Asian Nations (ASEAN) decided to launch the ASEAN Economic Community (AEC) initiative which was regarded as a significant milestone in the political, economic, and cultural integration of the regional grouping.

To affirm their commitment to realise the AEC, ASEAN leaders endorsed the AEC Blueprint in 2007 to accelerate the economic integration process and move towards the end-goal of transforming ASEAN into “a region with free movement of goods, services, investment, skilled labour, and freer flow of capital.” To date however, ASEAN is still far from achieving the goal of free movement of skilled labour.

The AEC Blueprint was meant to promote free movement of skilled labour with mutual recognition and harmonisation of standards in the education sector, professional qualifications and the overall job market. However, this initiative is lacking in practical policies as reflected in labour market



challenges in some ASEAN member states including Cambodia, Lao PDR, Myanmar and Viet Nam (CLMV).

In this regard, the main challenge is the shortage of skilled labour in the region. For example, 22 percent of the population is engaged in the manufacturing industry in Viet Nam but only one-fifth of this labour force is classified as skilled labour. Meanwhile, 11 percent and 16.7 percent of the populations in Lao PDR and Cambodia, respectively, are engaged in the manufacturing industry, comprising both trained and untrained workers. Even in more developed Indonesia, only one-third of the labour force is classified as skilled workers. Japanese manufacturing firms operating in Southeast Asia also cite the shortage of skilled labour as one of the key disincentives to investing in the region. The supply of skilled labour is not enough to meet domestic

demand, and even less to enable movement between the ASEAN countries.

The free movement of skilled labour requirement is also a very complex policy issue that needs mutual recognition and harmonisation of standards in the labour market—something that will necessitate substantial time and resources to achieve.

However, there does exist evidence of movement of skilled labour among ASEAN countries, driven by the foreign direct investment (FDI) strategies of Japanese firms. Japanese companies have a long history of investing in Southeast Asia, taking advantage of the region's low-cost labour and huge potential market. Among ASEAN members, Thailand and Indonesia were countries which received investments from Japan earlier than others. The investments brought capital, technology, and also technical skills from Japan to the host countries.

As part of their overseas operations, Japanese FDI firms provide technical training to the workforce of host countries. This creates positive spillover effects for the domestic labour market as workers gain greater technical expertise and skills from their on-the-job training.

As labour costs inevitably rise in host countries, Japanese firms relocate to more competitive labour markets, bringing jobs and training opportunities to less-advanced ASEAN economies. Thus, the decisions and strategies of Japanese FDI firms have played an important a role in the promotion and

movement of skilled labour in the region, especially in the CLMV countries.

Given the positive spillover effects of FDI to the domestic economy, the CLMV countries should focus on introducing policies that attract FDI. Not only does FDI provide job opportunities, but it also brings in much needed capital and new technologies to the host countries, as well as improve workplace standards and conditions.

The role of the private sector in facilitating free movement of skilled labour seems more straight forward to implement compared to regional initiatives. Companies will make decisions regarding processes, technical skills, and the duration of international transfers, including between which countries. The skilled labour standards of private companies also do not need complicated processes and qualification requirements as in the ASEAN framework. The standards of individual companies' systems are faster and simpler to implement than developing and launching a ten-country ASEAN labour market agreement.

Japanese firms exemplify the contribution of the private sector to the promotion and movement of skilled labour among ASEAN countries. At the individual country level, the policies needed for FDI promotion can be formulated to reflect local conditions. However, at the regional level, ASEAN can create programmes and policies which coordinate private sector support to promote the movement of skilled labour in the region.

Gradually, ASEAN will move from a multi-tiered grouping to a regional bloc comprising member economies with a highly skilled workforce and dynamic labour market. This transformation would pave the way for more advanced and balanced economic development to take place in the region. Moreover, free movement of skilled labour will help build the foundation for a strong and vibrant labour force that will lead to the realisation of an AEC that is inclusive, resilient, and sustainable.

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