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Pasierbiak, Pawel Mariusz

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# Causes, Origins and Possible Effects of the ASEAN Economic Community (AEC)

Pawel Pasierbiak

Maria Curie Skłodowska University

## Abstract

*In 2007, the Association of Southeast Asian Nations (ASEAN) at its 13<sup>th</sup> summit decided to create the ASEAN Economic Community (AEC). In assumptions, the common market was to be established by the end of 2015, and the introduction of free movement of goods, services, capital and skilled labor was to lead to an increase in the degree of market integration among member states. But the creation of a single market is not an easy process, as illustrated by the case of the European Community/European Union, where a process of single market creation has been implemented slowly and with numerous difficulties. On the other hand, if the process of a common market creation is successful, the integration brings benefits to the participating countries. The primary goal of this article is to indicate potential effects as well as to show the progress of the implementation and functioning of the common market in the ASEAN Economic Community. To achieve the objective, the author will analyze the theoretical implications of a common market and the real implications, taking the European Union as an example. Having done this part of the analysis, the author will try to indicate and evaluate the possible effects of the process of the common market creation in the Association of Southeast Asian Nations.*

**Key words:** ASEAN Economic Community, regional economic integration, the European Union, Southeast Asia

## Introduction

Regional economic integration is one of the most important processes in the contemporary global economy. Together with globalization, it is a significant tendency at the current stage of international economic relations development. The processes of regional economic integration take place in virtually all geographic areas, while their scope, scale, and intensity vary due to the chosen model of integration.

In Asia, the regional economic integration is taking place, even though it has different characteristics from those in Europe. While in Europe, these processes are rather institutional and instrumental, in Asia, they are mainly bottom-up market processes, developing between individual traders. Although regional integration in Asia is principally motivated by economic factors, there are also some institutional initiatives. If one were to take into account intraregional initiatives only in Asia, the ASEAN should be put in the center.

ASEAN is the most advanced East Asian regional grouping, seeking to pursue higher levels of economic integration.

One such initiative is the construction of an internal market, which would be a higher form of market integration. In 2007, ASEAN member states formally decided to roll out the establishment of the ASEAN Economic Community (AEC) by the end of 2015. Free movement of goods, services, capital and skilled labor, would constitute a significant step towards improving the economic competitiveness of the group.

The primary goal of this article is to indicate potential effects as well as to show the progress of the implementation and functioning of the common market in the AEC. To achieve the objective, the author will analyze the theoretical implications of a common market and the real implications by taking the European Union as an example. Having done this part of the analysis, the author will try to indicate and evaluate the possible effects of the process of the common market creation in ASEAN.

To achieve the goal, the author predominantly used a critical review of the literature and the descriptive method. Furthermore, to a limited extent, statistical data analysis was used.

### **Regional economic integration in theory**

The concept of regional economic integration has many definitions. The first of them were presented in the 1950s, but today the term continues to be newly defined vigorously. The very meaning of

the term 'economic integration' infers a spectrum of definition and depends on the individual approach of the author. It is all about the presentation of the essence of integration, what elements are considered the most relevant, and whether the definitions present all or only selected elements (Mucha-Leszko, 2012, pp. 16). These elements are: reasons, purpose, scope of integration, mechanisms of the functioning, model, the creation of common institutions and the creation of new international order. Thus, one can expect the definition of regional integration to vary from narrow to wide.

In the 1950s a definition was presented by J. Tinbergen (1954, pp. 95) as 'creation of the most desirable structure of the international economy, removing artificial hindrances to the optimal operation and introducing deliberately all desirable elements of coordination or unification.' This definition has been criticized as having too many evaluative terms, sometimes vague and ambiguous. Another definition, now recognized as a classic, was proposed by B. Balassa (1961). According to him, economic integration means the abolition of discrimination within an area. The author suggested that economic integration should be approached in static and dynamic manners. In the static approach, integration can be represented by the absence of various forms of discrimination between national economies. In the latter, integration encompasses measures designed to abolish discrimination between economic units belonging to different national states. B. Balassa

claimed that regional economic integration is carried out in stages, taking several successive and increasingly sophisticated forms (free-trade area through customs union, common market, economic union up to complete economic integration). In the 1960s, the wide definition of international economic integration was presented by Z. Kamecki (1967, pp. 93–94) as the 'formation, based on the developed single economic structure, of an economic organism comprising a group of countries, the organism which – due to the high degree of internal economic links and resulting from this internal economic cohesion – can be distinguished in a visible manner from the whole world economy.'

As mentioned, definitions of regional economic integration are also formulated today such as presented by P. Robson (1998, pp. 1), for whom international economic integration should be defined as the institutional combination of separate national economies into larger economic blocs or communities. This definition includes only one aspect of regional economic integration called regionalism. Regionalism means a planned, top-down process of integrating various economies in the same geographical area, due to the signing of trade agreements and/or economic cooperation. The second aspect of regional economic integration is called regionalization, which is formed by the intensification of economic interdependence on a regional scale, but resulting from bottom-up (market) development of trade, capital, financial or

production ties (Misala, 2005, pp. 434–435). In this case, we are dealing with the real component of integration (de facto integration). This distinction between de jure and de facto integration is essential from the point of view of the processes taking place in Asia as opposed to those in Europe. While in Asia economically driven integration dominates, in the case of Europe the process is more politically driven.

Theoretical analysis of regional economic integration would not be complete without a presentation of the benefits resulting from an accession to the grouping. In theory, authors try to identify the benefits and the costs of accession in various forms of integration. It should be noted, however, that joining the regional grouping realizes not only economic but also political and social objectives. Therefore, it is quite hard to find a quantitative measure of the ultimate combined effect of joining the grouping (Mucha-Leszko, 2012, pp. 17). In the short-term, benefits arise mainly from the increase in trade, but in the long run, they rely on the growth of production, factors of production productivity, GDP and GDP per capita growth.

J. Bhagwati and A. Panagariya (1996, pp. 82) believe that the theories of international integration passed through two phases of their development, each reflecting the current priorities of the different policy concerns. The first group of theories, so-called traditional ones, explains the possible benefits of integration and presents a static approach.

On the other hand, the second group, taking into account the changing trade and economic environment, presents a dynamic approach to an analysis of economic integration.

The standard (traditional) economics of preferential trade agreements is founded on the work of Jacob Viner who introduced two basic effects arising from the establishment of a free trade area or customs union: trade creation effect and trade diversion effect (Hosny, 2013, pp. 134). According to J. Viner countries will be willing to take regional integration in the form of a customs union when this action creates more static benefits than losses. In other words, the trade creation effect outweighs the effect of trade diversion.

The second group of theoretical concepts explaining the benefits of regional integration takes into account the dynamic effects of the process. These effects include economies-of-scale, technological change, the impact on market structure and competition, productivity growth, risk and uncertainty, and investment activity (Hosny, 2013, pp. 139). Since small markets increase costs, reduce the intensity of productive specialization, limit competition and weaken the tendency to technological progress, countries will likely seek to remove these disadvantages through the integration processes.

The selected theoretical concepts of regional integration presented above can be applied to real existing integration groupings, indicating effects of the

cooperation between member states. This issue will be partly a subject of further analysis of this study.

### **Benefits of common market – a case of the European Union**

The European Economic Community/European Union has gradually implemented the stages of market and monetary integration. Achieving the common market proceeded in stages, and the process has not always been smooth. The first stage was a formation of a customs union on 1 July 1968 (Watts, 2008, pp. 22) concerning trade in goods; however, agricultural products were still protected. Other freedoms (movement of services and factors of production), except for foreign direct investment, were not immediately provided. B. Eichengreen and T. Bayoumi estimated the effects of integration in the economic area. They found that the internal turnover within the EEC-6 as a result of the customs union creation increased faster by three percentage points on average (Mucha-Leszko, 2012, pp. 32). At the same time, the trade increase stimulated GDP growth by 3.1 percentage points per year. At the same time in the 1960s, the share of intra-trade within the group increased from 35% to 49%, which is a clear manifestation of the growing integration of the EEC.

In the 1970s and 1980s, the integration of markets of member states faced severe difficulties. Even regressive tendencies were observed. The economic slowdown, rising unemployment and weakening international competitiveness,

particularly in high technologies, as well as existing barriers to internal trade limited opportunities to benefit from integration. In order to overcome the above difficulties, the decision to create a genuine single market by the end of 1992 was made (Eichengreen, 2008, pp. 337). In 1985, the White Paper on Completing the Internal Market was published, which spelled out a program and a timetable for unifying European markets. The White Paper proposed an abolishing by the member states all remaining barriers to the free circulation of goods, services, persons and capital (European Commission, 1996, pp. 1). Elimination of internal barriers as a consequence of the Single European Market (SEM) was to lead to better resource allocation by improving comparative advantage and specialization. Also, it was expected to increase efficiency in many sectors, as the effect of the rationalization of the production resulting from greater use of economies of scale. In 1996 the European Commission presented a report on the overall effectiveness of measures taken so that the Single European Market could be created. The Commission (1996, pp. 1–11) analyzed the period of 1985-1995 and presented its assessment of the effects of the Single European Market:

1. The share of intraregional imports of industrial products increased by 6.7 p. p., from 61.2% (1985) up to 67.9% (1995). The share of intra-EU imports of services increased from 46.9 to 50%.
2. The impact of the SEM on foreign direct investment was higher than on trade – in the early 1990s, the EU was a destination for 44.4% of the global FDI inflow, while in the period 1982-1987 the share was 28.2%. Moreover, in the period from 1984 to 1992 intra-EU investments grew four times faster than intra-trade.
3. The share of intra-industry trade in the total exchange was increasing. In the years 1985-1992, it rose from 35 to 42% for products of different price and quality.
4. As a result of the SEM, there has been an increase in the GDP, which, depending on the model used, ranged from 1.1 to 1.5 percentage points. The main reasons for this increase were the increase in competition/efficiency and the rise in the total factor productivity (TFP), each accounting for around half of the overall effect.
5. Increased efficiency and competition resulting from the implementation of the SEM were made possible primarily due to the significant restructuring of European industries. In the period of 1985-1993, the reduction of costs associated with the size of the company resulted mainly from achieving greater economies of scale.
6. Implementation of the SMP has had a significant positive effect on the degree of competition in manufacturing sectors. The data on the reduction of the margin between costs and prices confirm this phenomenon.
7. Changes in the structure and degree of competition in the market, resulting from the implementation of the SMP resulted in increasing price convergence in the EU between 1985 and 1995.

8. Estimates of the impact of the SMP on employment showed a positive relationship. Depending on the model, the introduction of SMP resulted in an increase of employment by 300 000 up to 900 000.
9. The introduction of the Single European Market Project has brought real convergence among some member countries. The statistical analysis confirms that Ireland, Portugal, and Spain showed higher average economic growth rates after 1987, which proves the effect resulting from the implementation of SEM.

The analysis of the various areas of benefits creation was carried out mainly for the European Union, but it could be used as well to analyze other integration groupings organized on the principle of the common market. The liberalization of economic flows deals with the free movement of goods, services, and factors of production. An openness of markets and increased competition, as well as an increase in the size of the market, internal trade and improving the allocation efficiency of labor and capital, are the tangible benefits of the common market. As a result, gains from liberalization of the movement of goods, services, capital, and labor make up for the effects of the accumulation of the common market, namely GDP and income growth, increased economic and competitive strength of the region. There are also several mechanisms by which the common market also helps to improve the economic strength and competitiveness of the whole group in the world economy. It

is because of more intense competition, which leads to higher efficiency and greater attractiveness of the internal market for foreign investors.

The benefits mentioned above can be achievable by the ASEAN Economic Community. At the same time, it must be emphasized that AEC is not a typical common market according to B. Balassa's classification. Although it includes its essential elements, such as the freedom of movement of goods, services, capital, and people, this freedom is not full. AEC implements the 'common market minus' integration, which means that areas or sectors that are excluded from liberalization are still covered by joint actions (Soesastro, 2005, pp. 29). Additionally, the case of AEC is so interesting that it remains an attempt to move from the free trade area to the common market, bypassing the phase of the customs union.

### **Reasons behind the AEC creation**

Economic cooperation between ASEAN member states intensified in the early 1990s, with the entry into force of the ASEAN Free Trade Agreement (AFTA). Other initiatives undertaken (including those on investment, or services) contributed to an increase of the integration level, but member states have concluded that the creation of a qualitatively new initiative will bring additional benefits. In addition to the benefits, there were also some risks, which could have been avoided by the AEC creation. Several primary reasons for the formation of the AEC can be identified.

First is a need to remain competitive in an increasingly growing global competition (Austria, 2012, pp. 142). The growing importance of China and India, increased the interest of the member states to achieve benefits from a larger and more integrated internal market (Sakane, 2018, pp. 12). The broader and more cohesive market, the higher are the possibilities of achieving economies of scale in operations, which increases the attractiveness of the ASEAN internal market (ADB, 2008, pp. 86). Reduction of transaction costs, the progressive unification of the rules of origin requirements, improving infrastructure and logistics under conditions of global and regional value chains mean that the integrated market is easier to operate.

Second, the global trend towards regionalism has reinforced the need for more intensive economic integration. ASEAN had to start seeking investors and compete for their export markets much more actively.

Third, ASEAN must continue to maintain its credibility as the integration hub for FTA activities in East Asia (Austria, 2012, pp. 144).

Fourth, the implementation of increasingly sophisticated market integration would prevent excessive individual approaches to agreements by member states. This is a serious issue that has been called "noodle bowl syndrome." The creation of the AEC seeks to prevent further complications.

Fifth, the factors related to the external environment exert more pressure on ASEAN nowadays. Because the Asian crisis of 1997-1998, the Asian countries have realized the need to develop a common mechanism for achieving and maintaining economic stability and prevent future financial crises (Yean & Das, 2015, pp. 191). In addition, the crisis made countries realize that cooperation in both the real and financial spheres should grow together, and one of the conditions for achieving positive effects will be to ensure the free movement of skilled labor (Plummer, 2006, pp. 7).

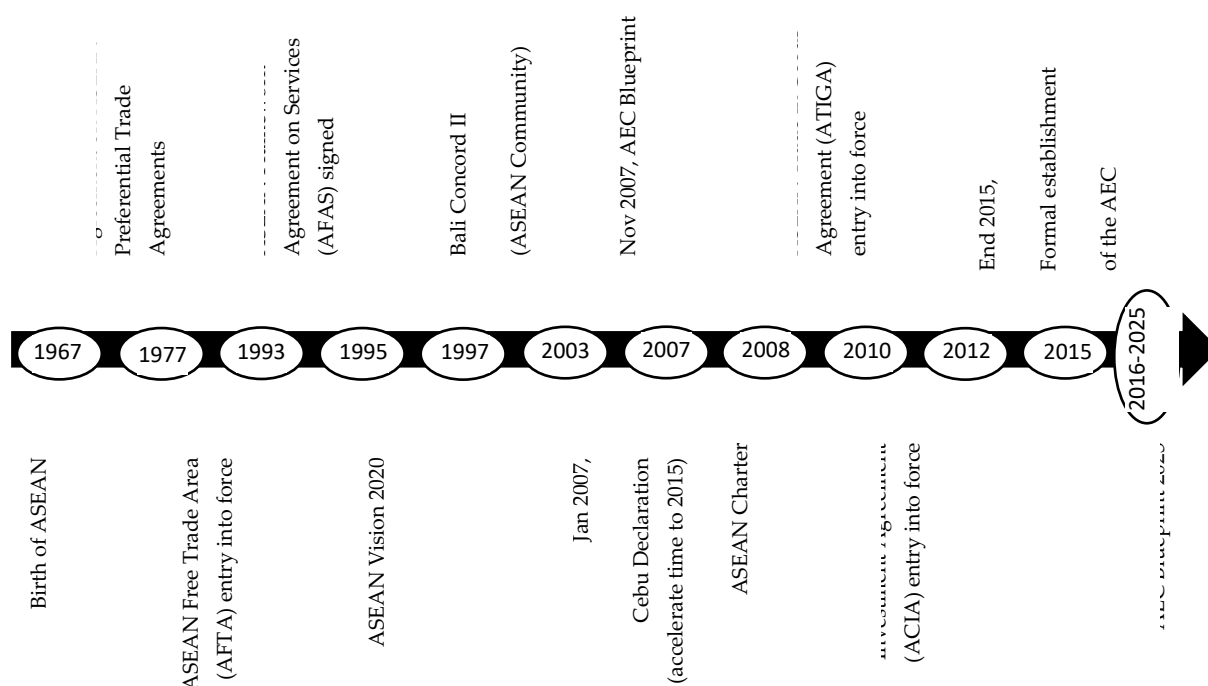
Sixth, the competitive threat of China has become more significant. The accession of this country to the World Trade Organization resulted in the increase of its attractiveness as a place of investment and production location. ASEAN decided to strengthen internal cooperation to improve economies of scale resulting from the functioning of the domestic market and thus improve their position towards China.

The above-described factors made the ASEAN leaders consider the future of ASEAN. The experience of AFTA, the ASEAN Framework on Services and the ASEAN Investment Area, were positive and promising. However, they may not be enough to maintain a competitive advantage, and most of all, empowerment of the grouping in East Asia. Therefore, in 2003 it was decided to deepen integration through the ASEAN Economic Community creation. The AEC was to be



the area with freedom of movement of goods, services, capital and skilled labor.

**Scheme 1. The ASEAN Economic Community Milestones**



Source: (ASEAN, 2015a)

### Road to the ASEAN Economic Community

The concept of the ASEAN Economic Community refers to the 1997 ASEAN Vision 2020, a document adopted in December 1997 at the summit in Kuala Lumpur. It marked the integrating countries and their long-term direction of actions. By 2020, ASEAN was to become the community based on three pillars: 1) ASEAN Security Community, 2) ASEAN Economic Community and 3) ASEAN Socio-cultural Community (Yean & Das, 2015, pp. 193). In October 2003 at the ASEAN Summit in Bali, it was decided to introduce AEC 2020 (Bali Concord II) (ASEAN, 2008, pp. 5). The primary objective of the AEC was 'to create a stable, prosperous and highly

competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in the year 2020' (Yean & Das, 2015, p. 193). In January 2007 at the summit in Cebu, the assumed date of entry into force of the community was shortened by five years – the AEC was to be finalized by the end of 2015.

In November of 2007, an important decision was adopted regarding the introduction of a specific action plan with strategic steps in its implementation - the 2007 AEC Blueprint. The Blueprint is organized according to the AEC's four objectives: 1) Single Market and Production Base; 2) Competitive Economic

Region; 3) Equitable Economic Development; and 4) Integration Into Global Economy. Clearly defined objectives and a timetable for implementation were introduced. In 2015 the formal establishment of the AEC was officially announced, but not all of its goals have been achieved. As a result, a new plan, which outlines the vision for AEC in the next decade (the AEC Blueprint 2025), was prepared (ASEAN, 2015c). The AEC Blueprint 2025 is based and develops the AEC Blueprint 2015 and consists of five areas: 1) A Highly Integrated and Cohesive Economy; 2) A Competitive, Innovative, and Dynamic ASEAN; 3) Enhanced Connectivity and Sectoral Cooperation; 4) A Resilient, Inclusive, People-Oriented, and People-Centered ASEAN; and 5) A Global ASEAN.

### **Assumptions and progress in realizing of ASEAN Economic Community**

As already mentioned, the decision about the realization of the ASEAN Economic Community was taken during the 9<sup>th</sup> ASEAN Summit held in Bali in 2003, but the concrete actions started in 2007 when the AEC Blueprint was introduced. The AEC's pillars and core elements are presented in table 1.

What is unique is the fact that the AEC Blueprint 2015 set out measures and schedules for their implementation, that is, during four two-year periods: 2008-2009, 2010-2011, 2012-2013 and 2014-2015. The primary instrument of measuring the progress on the AEC implementation – The AEC Scorecard mechanism – was

established in 2008. This is a self-assessment tool that monitors the achievement of milestones that were indicated in the Economic Blueprint's Strategic Schedule (Menon & Melendez, 2015, pp. 1). In the first two periods of implementation of the community, the AEC Scorecards were published. In subsequent phases of implementation they were not.

Information about implementation appears in different places and in an unorganized way. For example, after the 26<sup>th</sup> ASEAN Summit in Kuala Lumpur held in April 2015, the chairman stated that the rate of implementation of the AEC Scorecard stands at 90.5% (458 out of 506 measures) (ASEAN, 2015b, pp. 43). But the progress on the implementation rates for each pillar was missing. The same situation was observed in the ASEAN Annual Report 2013-2014 when it stated that by end-2013 81,7% of the 229 AEC prioritized key deliverables targeted by 2013 have been implemented (ASEAN, 2014, pp. 35).

In the report on progress in the implementation of the AEC (ASEAN, 2015a), the ASEAN Secretariat explained the changes that have occurred in the methodology of reporting progress towards the creation of the AEC. In 2012, at the 20<sup>th</sup> ASEAN summit adopted The Phnom Penh Agenda for ASEAN Community Building called for prioritizing high-impact activities and concrete, key measures to address the challenges and obstacles for realizing the AEC by 2015. As a result, two lists of

prioritized key deliverables (PKDs) were created – one for implementation by 2013 and another for implementation by 2015. From mid-2013 through 2014 reports on the implementation of the AEC Scorecard focused on these PKDs. The Secretariat stated that the implementation of all, not only the priority instruments, was monitored continuously and presented to ASEAN sectoral bodies. It seems that the

lack of information about the planned change has contributed to the lack of consistency of the analysis and the limited possibility of a comprehensive assessment. Below are the results of the AEC based on the information available. Table 2 presents detailed information on the implementation of the planned instruments in the first two phases (2008-09 and 2010-11).

**Table 1. The 2015 ASEAN Economic Community Blueprint**

Pillar	Core Elements
<b>A. Single Market and Production Base</b>	A1. Free flow of goods: 9 strategic approaches A2. Free flow of services: 3 strategic approaches A3. Free flow of investment: 5 strategic approaches A4. Freer flow of capital: 7 strategic approaches A5. Free flow of skilled labor A6. Priority integration sectors A7. Food, agriculture, and forestry
<b>B. Competitive Economic Region</b>	B1. Competition policy B2. Consumer protection B3. Intellectual property rights B4. Infrastructure development: 10 strategic approaches B5. Taxation B6. E-commerce
<b>C. Equitable Economic Development</b>	C1. Small and Medium-size Enterprises development C2. Initiative for ASEAN Integration
<b>D. Integration Into Global Economy</b>	D1. Coherent approach toward external economic relations D2. Enhanced participation in global supply networks

*Source:* (ASEAN, 2008, pp. 6–29).

The overall ratio for the two implementation periods listed in Table 2 reached 67.5%. Achievements in key areas have contributed to the overall ratio: ‘Single market and production base’ 65.9%, ‘Competitive economic region’ 67.9%, ‘Equitable economic development’ 66.7% and ‘Integration into the global economy’ 85.7%. The largest number of fully implemented instruments concerned the area of ‘Single market and production base’ (114 instruments in phase I and II). This area was however given only a 65.9%

rate of implementation, because 59 instruments were not implemented, mainly in the area of services. In turn, the highest rate of implementation was observed in the area of ‘Integration into the global economy.’ In this case, 12 instruments were implemented, while the number of not implemented instruments was 2. The relatively high number of implemented instruments occurred in the area of ‘Competitive Economic Region’ (53), but the same was true for instruments not implemented (25). This

provided the implementation rate of 67.9%.

What is rather worrying from the point of view of an implementation of the

ASEAN Economic Community is that the implementation of measures was losing momentum. This can be seen in Table 2 when examining the indicators during different phases and areas.

**Table 2. The AEC Scorecard for Phase I and Phase II (2008-2011)**

Specification	Phase I (2008-09)		Phase II (2010-11)		Total Measures	
	Fully implemented	Not-fully implemented	Fully implemented	Not-fully implemented	Fully implemented	Not-fully implemented
<b>Single market and production base</b>						
Free flow of goods	9	0	23	24	32	24
Free flow of services	10	3	13	17	23	20
Free flow of investment	5	1	5	8	10	9
Freer flow of capital	1	0	5	0	6	0
Free flow of skilled labor	.	.	1	0	1	0
Priority integration sectors	28	0	1	0	29	0
Food, agriculture, and forestry	8	0	5	6	13	6
<i>Total number of measures</i>	<b>61</b>	<b>4</b>	<b>53</b>	<b>55</b>	<b>114</b>	<b>59</b>
<i>Implementation rate</i>	<b>93,8%</b>	<b>6,2%</b>	<b>49,1%</b>	<b>50,9%</b>	<b>65,9%</b>	<b>34,1%</b>
<b>Competitive economic region</b>						
Competition policy	2	0	2	0	4	0
Consumer protection	2	0	5	4	7	4
Intellectual property rights	.	.	4	1	4	1
Transport	15	10	6	8	21	18
Energy	0	0	2	1	2	1
Mineral	1	0	7	0	8	0
ICT	2	0	4	0	6	0
Taxation	.	.	0	1	0	1
E-commerce	.	.	1	0	1	0
<i>Total number of measures</i>	<b>22</b>	<b>10</b>	<b>31</b>	<b>15</b>	<b>53</b>	<b>25</b>
<i>Implementation rate</i>	<b>68,7%</b>	<b>31,3%</b>	<b>67,4%</b>	<b>32,6%</b>	<b>67,9%</b>	<b>32,1%</b>
<b>Equitable economic development</b>						
SME development	1	0	4	3	5	3
IAI	2	0	1	1	3	1
<i>Total number of measures</i>	<b>3</b>	<b>0</b>	<b>5</b>	<b>4</b>	<b>8</b>	<b>4</b>
<i>Implementation rate</i>	<b>100%</b>	<b>0%</b>	<b>55,5%</b>	<b>44,5%</b>	<b>66,7%</b>	<b>33,3%</b>
<b>Integration into global economy</b>						
External economic relations	5	0	7	2	12	2
<i>Total number of measures</i>	<b>5</b>	<b>0</b>	<b>7</b>	<b>2</b>	<b>12</b>	<b>2</b>
<i>Implementation rate</i>	<b>100%</b>	<b>0%</b>	<b>78%</b>	<b>22%</b>	<b>85,7%</b>	<b>14,3%</b>

IAI – Initiative for ASEAN Integration

Source: Own preparations based on (ASEAN, 2012).

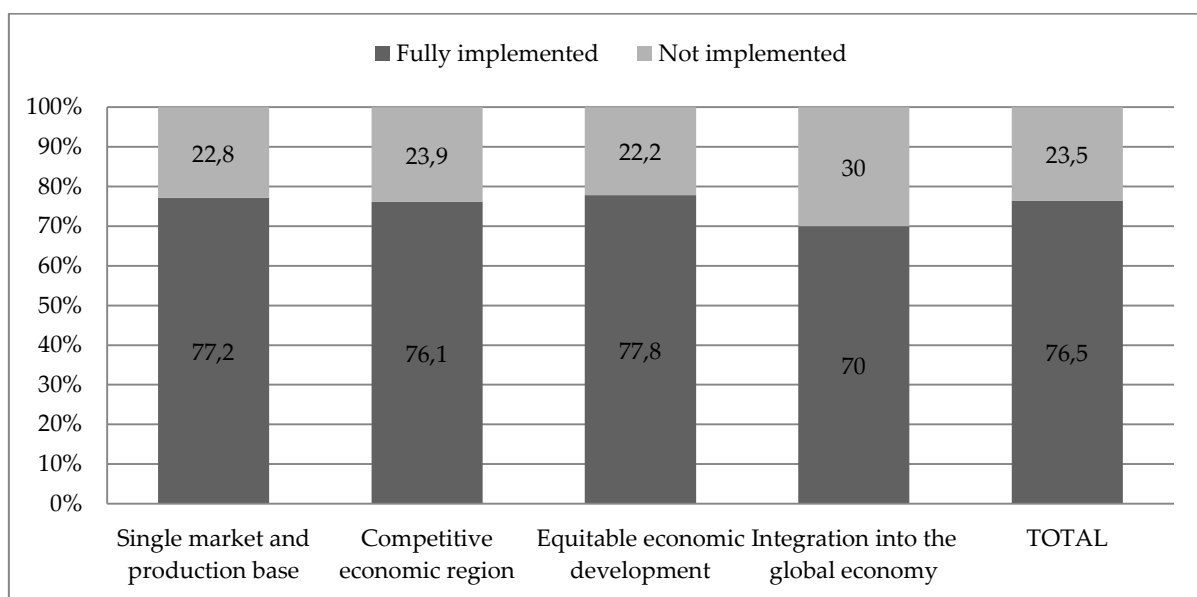
In 'Single market and production base' the indicator has declined from

93.8% (2008-09) to 49.1% (2010-11) in 'Competitive economic region' from 68.7

to 67.4%, in 'Equitable economic development' from 100 to 55.5%, and in the area of 'Integration into the global economy' from 100 to 78%. It seems that this situation resulted from the exhaustion of the ability to easily achieve the objectives. Initially, the easiest measures and indicators were implemented. Later,

along with the more difficult changes, implementation indicators deteriorated. This was not an optimistic situation from the point of view of the subsequent stages of integration. Perhaps, the deterioration of the indicators has changed along with the way of presenting integration achievements.

**Figure 1. ASEAN Economic Community Scorecard Key Deliverables, January 2008-March 2013**



Source: (Menon & Melendez, 2015, p. 2).

A further complication was the expansion of the list of measures included in the AEC Scorecard. Initially, 316 such measures were identified, however, with the passage of time and updates to the agenda, their number increased to 611 (as of October 2016). The presentation of achievements took an aggregated form for the entire period and selected priority areas. One such presentation is shown in Figure 1, depicting the AEC Scorecard Key Deliverables for the period January 2008-March 2013. According to data from Figure 1, the overall level of

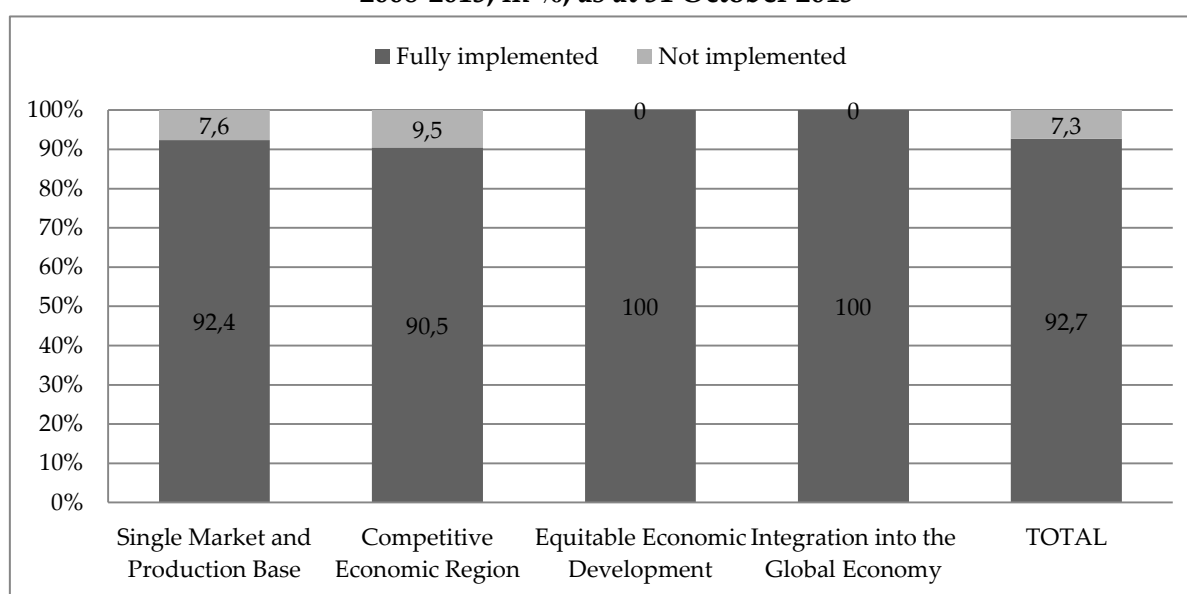
implementation of the planned measures. In turn, the highest level of implementation occurred in the area of 'Equitable economic development,' reaching 77.8%, and then 'Single market and production base' (77.2%). Unfortunately, as data is aggregated, one cannot discern the reasons for this level of implementation of measures in different areas.

Similarly, aggregated data were made public in 2015, while they relate to the period from January 2008 to the end of

October 2015 and another group of measures. In the last year before the formal establishment of the AEC, an overview of not implemented Prioritized Key Deliverables was prepared. Based on the evaluation of their implementation possibilities by the end of 2015 and on their importance for the trade development, 54 measures were selected

(high-priority measures – HPMs). Together with the measures implemented since 2008, HPMs form a group of 506 measures to monitor the implementation of the AEC (ASEAN, 2015a, pp. 9). Figure 2 shows fully implemented ASEAN-wide and high-priority measures by the AEC Pillar for the period January 2008 – October 2015.

**Figure 2. Fully Implemented ASEAN-wide and high-priority measures by the AEC Pillar, 2008-2015, in %, as at 31 October 2015**



Source: (ASEAN, 2015a, pp. 9).

According to data presented in Figure 2, the change in the number of measures under consideration has increased the overall rate of implementation in priority areas up to 92.7%.<sup>1</sup> In the 'Single market and production base' 256 measures were implemented (92.4%), while the number of not fully implemented was 21 (7.6%). On the other hand, in 'Competitive Economic

Region's 154 measures were implemented (90.5%) and 16 not implemented (9.5%). The other two fields were claimed to be fully implemented (ratio implementation was 100% in both cases).

An assessment of the degree of implementation of the AEC solely on the AEC Scorecard is subject to the risk of error (Menon & Melendez, 2015, pp. 2–3). First, there is no certainty whether the AEC Blueprint covers all needed measures so that the establishment of the common market could be possible. Second, as the

<sup>1</sup> When all the instruments declared earlier (611 in total) are considered, the implementation rate decreases to 79.5%, or 486 measures (ASEAN, 2015a, p. 10).

AEC Scorecard is a compliance tool that relies on self-assessment, there could be a willingness to give overestimated compliance and achievement (Jones, 2016, pp. 648). Third, the AEC Scorecard measures the aggregate process, and it does not take into account differences within individual countries. Fourth, the scorecard fails to capture differences in speeds of liberalization among member states fully. Fifth, the AEC does not analyze and explain results. Sixth, there is no efficient mechanism for exerting peer pressure on member states when the AEC targets are missed.

Taking into account the above, it is worth taking a closer look at the most crucial achievement of the ASEAN member countries in their quest to establish the ASEAN Economic Community. The most critical areas developed in the AEC Blueprint 2015 will be explored. The primary sources of information are documents such as: (ASEAN, 2015d), (ASEAN, 2015b), (ASEAN, 2014), (Menon & Melendez, 2015), (Chia, 2013).

### **Pillar 1. Single Market and Production Base**

Pillar 1 is the most critical element of the AEC. It includes items such as: free flow of goods, free flow of services, free flow of investments, free flow of capital and free flow of skilled labor. The most significant achievement in the area of free flow of goods is a reduction of tariffs among members. In 2014, the average ATIGA rate for all ASEAN member states stood at the level of 0,54%, while MFN

average at the level of 6,9%. For ASEAN-6 tariffs have fallen to virtually zero, while for other countries (Cambodia, Lao PDR, Myanmar and Viet Nam - CLMV) have been declining up to their planned elimination in 2018 (ASEAN, 2015d). According to Menon and Melendez (2015, p. 5) the progress was possible as achievements in Pillar 1 relate to 'low hanging fruit.' More sensitive areas of reforms remain – such as opening up the agriculture sector, steel, and motor vehicles. What is characteristic and not necessarily good for the assessment of the ASEAN free flow of goods, is the fact that utilization of the common effective preferential tariffs has been relatively low. There are some reasons behind this: difficulties complying with rules of origin (because of the high level of product fragmentation in the region, high import content of major export products, administrative costs of proving origin); lack of progress in reducing non-tariff barriers (NTBs) to intra-ASEAN trade.

Services market integration in the ASEAN is conducted under the 1995 ASEAN Framework Agreement on Services (AFAS). Nine packages of commitments under AFAS have been concluded. Even though AFAS commitments have improved over time, liberalization in services was hampered by flexibilities introduced in the 'ASEAN-X' formula. This formula allows member states to liberalize according to each country's readiness – this is one of the barriers in progress of liberalization process.

'Free flow of Investment and Capital' is one of the most important goals of the AEC. In the AFTA one of the key objectives was to remove barriers to trade to attract foreign direct investment in regional production networks. In 1998 the ASEAN Investment Area (AIA) was established. While it was to facilitate FDI inflows, the scope of the AIA placed too much emphasis on intra-regional FDI. It granted national treatment to ASEAN investors by 2010 and to non-ASEAN investors by 2020 (Chia, 2013, pp. 20). The full realization of the AIA was advanced to 2010 for ASEAN-6 and 2015 for CLMV. In 2012 the ASEAN Comprehensive Investment Agreement came into effect and superseded the earlier agreement (Yean & Das, 2015, pp. 195). The initiative is seen as a way toward enabling the most important investors (external as the EU, the US, China etc.) to be treated equally to national enterprises. The ASEAN Comprehensive Investment Agreement offers investment liberalization, investment facilitation, investment protection and investment promotion.

The AEC Blueprint stated that strategic actions for a free flow of skilled labor are: facilitating the issuance of visas and employment passes, MRAs for major professional services, core concordance of services skills and qualifications. Mutual Recognition Arrangements are one of the most important instruments for skilled labor mobility in ASEAN. By date the MRAs were concluded for (ASEAN, 2015a, pp. 33): 1) Engineering Services (2005); 2) Nursing Services (2006), Architectural Services (2007); A

framework for Surveying Qualifications (2007); Medical Practitioners (2009); Dental Practitioners (2009); A framework for Accounting Services (2009) replaced by MRA on Accountancy Services (2014) and Tourism Professional (2012). Although some actions and initiatives were introduced, the majority of labor flows occurs independently of these arrangements and is market-driven. Quite the opposite of assumptions, the overwhelming share of labor flows within ASEAN is in low- and semi-skilled labor.

## **Pillar 2. Competitive Economic Region**

The second pillar of the AEC comprises such areas (among others) as: competition policy, intellectual property rights protection, consumer protection and infrastructure development (see table 1). Activities undertaken in all these areas lead to lowering production and transaction costs, encouraging more efficient allocation of resources and improving consumer welfare. Business climate improvements attract more FDI inflows. Several initiatives for competition policy were introduced in ASEAN such as a formation of the ASEAN Expert's Group on Competition (2007), ASEAN Regional Guidelines on Competition Policy, Handbook on Competition Policy and Laws in ASEAN for Business. According to Menon and Melendez (2015, pp. 9), five ASEAN member states have comprehensive competition policies and laws, while the others were working on the introduction of competition policy and law by 2015.



In the field of Intellectual Property Rights, some actions have been undertaken. For instance, the ASEAN Working Group on Intellectual Property Cooperation (established in 1996) was to assess the implementation of the ASEAN IPR Action Plan 2011-2015. Additionally, the Task Force on Trade Mark has been established to complete the Trade Marks related action lines by 2015. It seems that competition policy and intellectual property rights protections are sensitive areas of the ASEAN integration. Although the Blueprint mentions a commitment to integrate the regional economy, competition policy and IPR protection are national in application. Keeping in mind the differentiated level of development of the ASEAN member states, it does not appear that full uniformity in competition and IPR rules is possible soon.

Developments in physical and telecommunication infrastructure took place in ASEAN, but there is a lot to be done. The main problem is to coordinate different national needs with the regional vision and plans. Another issue is a huge need for financing. In ASEAN the wealthiest countries are the smallest, so there is a necessity to use different methods and sources for infrastructure development. Even if there are gains in infrastructure development, this can be challenged in the area of transport liberalization.

### **Pillar 3. Equitable Economic Development**

The Third Pillar of the AEC Blueprint 2015 aims to address issues

connected to intra-country development gaps and the development gap between ASEAN-6 and CLMV. Measures foreseen in the Blueprint consist of SME development and Initiative for ASEAN Integration (IAI). Under the Strategic Action Plan for ASEAN SME Development (2010-2015) a few projects have been realized: the ASEAN Business Incubator Network, the ASEAN SME Guidebook towards the AEC 2015, ASEAN Online SME Academy. The IAI was invented to be a framework for regional co-operation where more advanced (richer) member states could contribute resources and expertise to the less developed ones.

### **Pillar 4. Integration into the Global Economy**

In the fourth pillar of the AEC Blueprint, we can see the most significant progress. Multilateral and unilateral actions taken by ASEAN countries have led to a reduction of trade barriers in goods, services as well as investments. This has made the ASEAN one of the most open regions in the world economy (Menon & Melendez, 2015, pp. 12). On the other hand, since 2000 there is a proliferation of FTAs among ASEAN member states. However, these FTAs deal solely with tariffs and do not address regulatory and other non-tariff barriers such as product standards, services, investments, intellectual property rights, government procurement and movement of business people. ASEAN's FTAs are not supportive of regional economic integration; they create many problems,

usually described as the 'spaghetti bowl.' One of the examples is the Regional Comprehensive Economic Partnership (RCEP) which started to be negotiated in 2012. The ASEAN negotiates with six other countries (Australia, China, Japan, Republic of Korea, India and New Zealand), but the partnership will add to, rather than replace, existing ASEAN+1 FTAs. The RCEP also uses the 'flexibility' clause, which allows the inclusion of provisions for special and differential treatment and some provision for lesser developed countries. Differences in the detailed provisions of individual FTAs are another point of concern. For instance, rules of origin provisions can vary significantly from agreement to agreement. This elevates the level of difficulty in harmonizing agreements. This has not mentioned the negotiation of interregional agreements by individual member countries instead of the whole ASEAN such as agreements of Singapore and Viet Nam with the EU (Mazur, 2017).

The above-presented assumptions and achievements of the implementation of the ASEAN Economic Community allow for some assertions. The analysis of the various areas of integration shows that there is still much to be done. If the implementation of the AEC is measured by the implementation of the planned actions and activities, the AEC has not fulfilled its objectives (i.e., the culmination of the process by the end of 2015). Many authors emphasize, however, that the aim of the establishment of the AEC should be considered as a milestone, not as an end of the process. If economic integration in

ASEAN is to develop, this approach seems appropriate.

### **Possible effects and problematic issues of the process**

Potential impact on the growth of wealth as a result of the establishment of the ASEAN Economic Community has been the subject of research, and the results have been presented in several publications. According to a computable general equilibrium (CGE) model presented by Plummer and Chia (2009), an additional increase of wealth as a result of the realization of the AEC would amount to 5.3 percentage points (Chia, 2013, p. 12). All member states would benefit from that, but Singapore would benefit the most (9.7 p.p.), together with Brunei Darussalam (7.0) and Cambodia (6.3). The lowest gains would be attributed to Viet Nam (2.8) and Malaysia (3.0).

Other estimates prepared by the Economic Research Institute for ASEAN and East Asia (ERIA) show that the effect of GDP growth as a result of tariff reductions would be small, but the most substantial impact would be from the reduction of barriers in the services sector and time savings associated with the introduction of trade facilitation and infrastructure improvement (Chia, 2013, pp. 12). In 2014, the Asian Development Bank together with the International Labor Organization conducted a study that showed that the full implementation of the AEC Blueprint 2015 would lead to an increase in regional GDP by 7.1% and create 14 million additional jobs by 2025 (ILO-ADB, 2014, pp. 39, 52). In most cases,

this would include less economically developed ASEAN countries.

In turn, the McKinsey Global Institute in its report states that the introduction of the AEC could cause a shift of global manufacturing from China toward the ASEAN. As a result, by 2030, annual GDP for the entire grouping could increase from 280 to 615 billion USD, which would represent 5 to 12% of ASEAN's GDP in 2030 (Woetzel, Tonby, Thompson, Burt, & Lee, 2014, pp. 4).

The estimates presented above are subject to an error resulting from theoretical assumptions. However, they all show the benefits ASEAN could gain as a result of the AEC. However, those benefits are not guaranteed. On the contrary, they can be hard to achieve. So far, it is said, that the AEC brought fewer benefits than had been expected. This is because there are some problems ASEAN faces. According to K. Sakane (2018, pp. 12–13), there are several significant obstacles to the AEC development, namely: still existing domestic non-tariff barriers; regulatory frameworks on transport facilitation (even if physical infrastructure developed); low integration of service sector in the region; difficulties with implementation of free flow of skilled labor; little progress of capital market integration. According to K. Sakane, due to these obstacles, the AEC is far behind the EU.

M. G. Plummer (2006) compared the creation of the AEC with the experiences of the European Union. He pointed out certain similarities and

differences that can be summarized in a few points. First, the institutional environment in ASEAN is now much different from that of the European Economic Community (EEC) in the 1950s. The political and social motivations for economic integration in Europe were far different from ASEAN's today. Institutional development in the ASEAN is difficult as: 1) nation-state formation was much later than in the European context; 2) divergence in socio-political institutions is larger than in Europe; 3) European institutions are successful in economic-related matters; 4) European institutions are rather costly and ASEAN's budget much smaller. Second, the international economic environment is far different nowadays than in the 1950s. The global marketplace is much more open nowadays. This means that the current cost of the diversion effect resulting from the integration is significantly higher than in the past. Third, ASEAN faces much greater internal economic diversification. This results in the fact that the possibility of implementation of the AEC will be more complicated and difficult. Even the possibility of taking into account all the countries in the process will be difficult. This is expressed in the 'flexibility' approach, the example of which is the inclusion of ASEAN-X rules in the liberalization of services. Fourth, ASEAN is now much more open than the EEC was in the 1950s.

These different conditions make it impossible to transfer the European experience directly to the Asian theater. Nevertheless, there are some experiences

of European integration, which ASEAN can learn from. Firstly, ASEAN should not solely focus on the internal market and pursue a policy of inward-looking discrimination. This would be particularly disadvantageous, keeping in mind that as many as 75% of the total of ASEAN's trade is directed outwardly. Secondly, the example of EEC/EU shows that trade and investment are strictly interconnected with the change of the economies' structures. This is also the case for ASEAN. Thirdly, the European Union has gained from internal trade liberalization. The creation of a customs union and a single market was important because it led to the reduction of transaction costs. This resulted in a more efficient international division of labor in most of EU's member states. ASEAN should focus on creating not only the internal market but on the creation of global economic relations.

### **Prospects of the ASEAN Economic Community**

Most observers of integration processes in ASEAN have realized that the formal establishment of the ASEAN Economic Community in 2015 does not end the integration process. What is more, they treat the AEC as a milestone towards further integration. Also, decision-makers in the ASEAN realize that there is still a lot to do. All this resulted in the adoption of the new plan – the ASEAN Economic Community Blueprint 2025 (ASEAN, 2015c). The document states that the overall vision articulated in the AEC Blueprint 2015 remains relevant. The new

Blueprint builds on the AEC Blueprint 2015. The priority is to complete the unfinished Implementation of Measures under the AEC Blueprint 2015 by end-2016. As the Blueprint states, in the next decade, ASEAN will also provide a new emphasis on the development and promotion of micro, small and medium enterprises (MSMEs) in its economic integration efforts (Bobowski, 2017). At the same time, ASEAN will likewise embrace the evolving digital technology as the leverage to enhance trade and investments, provide an e-based business platform, promote good governance and facilitate the use of green technology. For the monitoring and assessment of The AEC Blueprint 2025 implementation, The AEC 2025 Monitoring and Evaluation (M&E) Framework was introduced (ASEAN, 2018).<sup>2</sup>

It should be remembered that the creation of formal plans is not sufficient to achieve real economic integration. It is necessary to convince the member states about the benefits that result from the deepening of integration and get their commitment. Sizeable internal diversity, conflict of interest and the Asian style of discussion can be reasons opposing a statement that economic integration within ASEAN will develop systematically. On the other hand, it shows that determining a particular date (2015, 2025) is mobilizing for (some) member states. Without such fixed date

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<sup>2</sup> Due to difficulties in data gathering, the evaluation of the implementation of The AEC Blueprint 2025 will be of interest to the author in the future research.

progress in the economic integration of ASEAN would be far lower.

### **Conclusion**

At the end of 2015, the creation of the AEC was announced. Although the comparison with the Single European Market was automatically imposed, it is not entirely appropriate. The AEC is not a typical common market with features as pointed out in theory nor it is similar with that in the European Union. In ASEAN, a model called 'common market minus' is implemented. Moreover, in the integration process in ASEAN, it was decided to bypass the customs union as an intermediate form between the free trade area and the common market.

ASEAN realizes that deeper integration is needed, but because conditions are different, it uses other methods of intensifying cooperation.

Firstly, the much higher than in Europe diversity between countries (e.g., economic, political, religious, cultural, linguistic) causes that ASEAN Way is perhaps a reasonable strategy used in negotiations. However, it affects the effects of integration, its dynamics, and scope negatively. ASEAN countries are sensitive to even small attempts to limit their sovereignty, so they do not show a willingness to transfer of national competences (this is why there is no customs union because here it would be necessary to conduct at least a common external tariff). National interests are more important than those of the community, which means that integration is uneven.

This is confirmed by data showing the stages of the AEC implementation. After a relatively good beginning, the following years brought a weakening of the dynamics of change. This is probably the effect of 'low hanging fruits.' It is currently more difficult to implement increasingly advanced integration tasks. The effects of AEC are lower than assumed because barriers still exist. The lack of fulfillment of the conditions of the common market results in lower effects than expected in theory (lack of free flow of labor causes suboptimal allocation of production factors, which limits the increase in their productivity).

Secondly, integration within the AEC is carried out under different external conditions. If  $\frac{3}{4}$  ASEAN trade is realized with third countries, it is difficult to expect strong promotion of internal integration, excluding third countries from the market. This would involve high costs of the trade diversion, especially under conditions of high dependence of ASEAN countries on the Chinese market.

To conclude, it can be said that the ASEAN Economic Community is an interesting initiative undertaken by ASEAN, however, different from the classic common market and the Single European Market. It is good that the initiative was formulated and implemented, but at the moment it is difficult to determine its effects reliably. This will be possible only in the future, and it will be of interest to the author of this study.

### About the Author

The Author works in the Chair of World Economy and European Integration at the Faculty of Economics of Maria Curie Skłodowska University in Lublin, Poland. His main discipline is international economics and in particular regional economic integration in Europe and East Asia. He also researches on economic development and position of individual Asian countries as well as on economic relations between both countries and groups of countries.

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