

# THE ASEAN EXPERIENCE, NORTHEAST ASIA AND BEYOND: FREE TRADE AND ECONOMIC INTEGRATION

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## INTRODUCTION

Economic regionalism has been an observable phenomenon worldwide. Many countries around the world pursue some degree of economic integration with neighbouring countries, in the hopes of capitalizing on the benefits of such an arrangement. At the turn of the 21<sup>st</sup> century, there already existed various regional economic institutions, including the highly integrated Eurozone in Europe and the East African Community (EAC) for continental Africa. This is in addition to a proliferation of bilateral free trade agreements (FTAs) between countries, which can be regional or cross regional in nature. Many Asian countries, including South Korea, China and Singapore, have also been active participants in these economic processes, with many FTAs signed intra and inter-region. The Association of Southeast Asian Nations (ASEAN),<sup>2</sup> recognizing the preponderant benefits that can be derived from trade ties, have been among the most vocal advocates of economic regionalism, an institution that goes beyond bilateral FTAs. Unlike bilateral FTAs, regional institutions include more than just two parties, thereby enabling more countries to benefit from trade together. Against this backdrop, the ASEAN Economic Community (AEC) is currently being implemented incrementally by all member states, according to a chronological roadmap. The AEC is expected to deliver substantial economic gains to all

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<sup>2</sup> The ASEAN countries are Singapore, Indonesia, Laos, Cambodia, Myanmar, Malaysia, the Philippines, Thailand, Brunei and Vietnam.

member countries, including increased access to regionally produced goods, better allocation of capital resources and overall improvement of economic well-being to the people in ASEAN. Yet, the creation of the AEC did not come without its obstacles. Much effort was – and continues to be – channeled towards coordination, alignment of interests and resolution of conflicts. As is encountered even in the Eurozone and the EAC mentioned earlier, all regional economic institutions have to overcome various establishment and maintenance problems that can hinder the efficacy and effectiveness of such institutions. Thus far, the AEC appears to be coping with these barriers well. If it can do so successfully, the economic benefits accrued to member countries will be considerable.

Economic integration provides promise of improving societal welfare through market mechanisms, but also closer inter-state ties and improved intra-regional peace and stability. Much scholarship has been devoted towards exploring the political difficulties that undergird economic integration. Tensions from historical or ideological issues have been attributed as problems that hinder cooperation.<sup>3</sup> Therefore, a common line of argumentation could hold that resolving these political problems must occur prior to cooperation between these states. However, evidence on this count is inconclusive. For example, the United States (U.S) and China were able to set aside ideological differences, despite decades of tension, in favour of cooperating against the Soviet Union. This implies that the tangible benefits from economic integration could provide the motivation to isolating or resolving major political differences. If there are clear material benefits at stake, as in the Soviet threat of the 1970s, there are reasonable grounds to posit that states may be willing to pursue self-interest before considering less immediate and non-threatening problems, such as ideology. As this paper will show, the AEC is a powerful force promoting peace in the Southeast Asian region. Greater labour mobility within this region, coupled with the material gains from collective economic growth are major stabilizers that mitigate unnecessary conflict. In other words, national behaviour increasingly adapts to ensure that economic development is prioritized. If a government cannot guarantee its people security in their basic material needs, then there can be no foundation to pursuing higher-level, abstract goals such as ideological legitimization.

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<sup>3</sup> Rafael Reuveny and Heejoon Kang, "Bilateral trade and political conflict/cooperation: do goods matter?," *Journal of Peace Research* 35, no. 5 (1998): 581-602. See also Robert O. Keohane, *After Hegemony: Cooperation and discord in the world Political Economy* (Princeton: Princeton University Press, 2005.)

Assuming the logic of economic integration holds true, Northeast Asia stands to profit immensely if the region creates a similarly structured economic institution. As such, this paper argues that Northeast Asia's ability to increase economic integration's viability can be greatly enhanced by understanding how ASEAN has approached the creation of the AEC. There are both economic and political-security benefits which can greatly enhance the attractiveness of creating a "Northeast Asian Economic Community" (NAEC). In the first section of this paper, I perform a case study of ASEAN to better understand the actual and potential benefits of the AEC's creation, followed by a distillation of lessons that can be learnt, pertaining to how major barriers to successful economic integration have been - and are still being - mitigated. The second section will then proceed to examine the benefits of forming the NAEC and suggest how, by way of the ASEAN experience, significant barriers to economic integration can be overcome to increase the possibility of successfully creating the envisaged NAEC. The final part of this paper will articulate the possibility of a more encompassing East Asian economic community, contingent on the success of the AEC and NAEC.

## **I - THE ASEAN WAY TO ECONOMIC INTEGRATION**

Historically, Southeast Asia was a major node in the international trade network, exposed to major movements of goods between different nations around the world. Following post-colonialism, however, many member countries turned to import-substitution industrialization in order to develop their economies. In recent decades, more countries have increasingly embraced the idea of free trade, persuaded by the benefits that it can provide. The ASEAN Economic Community (AEC) was conceptualised in 2003, following the meeting of ASEAN heads-of-state in Indonesia, and is part of a larger concept of regional integration.<sup>4</sup> The AEC aims to create a common economic platform that will facilitate the participation and trade of ASEAN member countries. Its main pillars are: 1) a single market and production base; 2) a competitive economic region; 3) equitable economic development; and 4) integration into the global economy.<sup>5</sup> With

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<sup>4</sup> ASEAN, *Declaration on the ASEAN Economic Community Blueprint*, ASEAN Website, January 2008, Accessed May 1, 2015, <http://asean.org/wp-content/uploads/archive/5187-10.pdf>.

<sup>5</sup> Ibid.

the integration of the AEC, the total value of the economic market is estimated at US\$2.3 trillion.<sup>6</sup> As a large market with considerable promise, the AEC is an attractive region for robust economic growth. It is in this regard that many countries have been convinced to participate in the AEC, as the tangible and rational benefits accrued to each country will go a long way in promoting the economic health and societal welfare of their respective countries.

### How the AEC benefits its member countries

First, the AEC provides countries with incentives to align their production bases according to their comparative advantages. For many Southeast Asian countries, most countries retain a large agrarian base, with only a few having successfully transitioned to a more capital-intensive economy.<sup>7</sup> For example, Singapore and Malaysia are the leading economies in the region and both have considerable infrastructure tailored to meet the needs of a more knowledge-based, high-value economy. This is aligned with their comparative advantages, especially so for Singapore. Public universities, such as the National University of Singapore and Nanyang Technological University, have consistently been recognized for academic excellence in various world rankings, while other technical and vocational training institutes provide Singaporeans with the needed skills that employers from MNCs look for.<sup>8 9</sup> As a result, Singapore in general has emerged as a strong and competitive economy. On the other hand, the Philippines, with a large agrarian base, is presently much poorer than Singapore. Without specialization, it will be difficult for the Philippines to achieve economies of scale via large-scale efficient production of goods according to their comparative advantage in primary products, such

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<sup>6</sup> KPMG, *The ASEAN Economic Community 2015: On the Road to Real Business Impact*, June 2014, Accessed May 5, 2015, <http://www.kpmg.com/SG/en/IssuesAndInsights/ArticlesPublications/Documents/Tax-Itax-The-ASEAN-Economic-Community-2015.pdf>.

<sup>7</sup> Quah, Jon ST, *Public Administration Singapore Style*, Vol. 19 (Bingley: Emerald Group Publishing, 2010).

<sup>8</sup> Based on the QS University Rankings, the National University of Singapore and Nanyang Technological University, were respectively ranked 12<sup>th</sup> and 13<sup>th</sup> in the 2016 edition.

<sup>9</sup> J.S. K. Yip & Sim, W.K, *Evolution of Educational Excellence: 25 Years of Education in the Republic of Singapore* (Singapore: Longman, 1990).

as agricultural goods.<sup>10</sup> The AEC aims to address this by encouraging economies to re-align according to their strengths. In doing so, other trading partners within the AEC will benefit from lower prices, thereby enhancing consumer welfare.

Second, the AEC effectively creates an integrated market for 611 million consumers.<sup>11</sup> A large consumer base will be advantageous to many firms located within member countries, as their product reach will be greater than before. Where successful integration without significant trade barriers prevails, social welfare improves as raw material and final product prices are not unnecessarily distorted. It is little wonder, therefore, that many countries are receptive of the AEC since this will increase both domestic consumption and export expenditure, enhancing the interest of their respective business sectors. Consumers in the AEC will be exposed to even more product choice, variety and nature at a higher level of quantity and quality. Already, benefits have been apparent. For example, Jollibee, a fast food restaurant chain from the Philippines, has successfully expanded its operations into nine of the ten ASEAN nations as a result of lower trade and investment barriers. Today, its operations are worth a total of US\$866 million.<sup>12</sup> The presence of a large market is also effective in attracting foreign direct investment from other parts of the world. This sentiment was captured in a survey by the US Chamber of Commerce, which polled and discovered that 54% of American firms have plans that involve expanding into ASEAN.<sup>13</sup> Such investments can go a long way in strengthening the regional economy even further, thereby enhancing the overall returns to integration. Specifically, more jobs can be created and economic development achieved. Effectively, consumers will benefit alongside business and every country is moved along in this cycle of economic prosperity.

Third, the AEC's success can promote greater regional peace and ameliorate security-related challenges. Economic competition has often been im-

<sup>10</sup> Ana Shohibul, "Revealed comparative advantage measure: ASEAN-China trade flows," *Journal of Economics and Sustainable Development* 4, no. 7 (2013): 140.

<sup>11</sup> ASEAN, *Declaration on the ASEAN Economic Community Blueprint*.

<sup>12</sup> ASEAN, *Thinking Globally, Prospering Regionally: ASEAN Economic Community 2015*, ASEAN Website, April 2014, Accessed May 1, 2015, <http://asean.org/storage/2016/06/4.-March-2015-Thinking-Globally-Prospering-Regionally-%E2%80%93-The-AEC-2015-Messaging-for-Our-Future-2nd-Reprint.pdf>. [http://www.asean.org/images/resources/2014/May/AECKeyMessagesBooklet\\_FINAL30Apr2014.pdf](http://www.asean.org/images/resources/2014/May/AECKeyMessagesBooklet_FINAL30Apr2014.pdf).

<sup>13</sup> Ibid.

plicated in political conflicts among states (Le Billon, 2004). The presence of the AEC provides all states with positive security externalities, specifically, a buffer against unnecessary conflict caused by economic fundamentals. Under conditions of shared economic growth and prioritized economic cooperation, the benefits of a successful AEC will be enjoyed by all ASEAN states. Fostering an economic community can also provide additional benefits to regional peace, following economic liberalism. According to economic interdependence theory, states that form a network of cross-border cutting economic ties will be more disposed towards peace and less towards conflict. If the theory is true, the presence of the AEC will be a major driver of regional peace in ASEAN. While no studies have been conducted in ASEAN yet, economic interdependence theory tentatively has some support from research conducted by Russett and Oneal, who established the presence of a positive relationship between trade and peace.<sup>14</sup> This is salient, as ASEAN leaders such as Singapore's Prime Minister Lee Hsien Loong have identified growing nationalism as a threat to regional stability.<sup>15</sup> Integration in the economic sphere, in turn, can serve as a viable launch pad for better and more stable political and social relations across the region. Building a stable and powerful AEC will be advantageous to promoting peace in Southeast Asia, a goal that is desirable in the context of greater political conflict among East Asian states. This being achieved, peace in Southeast Asia will be a good base to enhance peace in the greater East Asia region.

### Lessons from the ASEAN Experience

Following the above, it is apparent that economic cooperation is desirable as it provides economies access to a larger market, fosters economic competitiveness and carries positive security externalities. Together, these attractive 'push' factors encourage states to seek out such an arrangement. Against this backdrop, there is cautious optimism that Northeast Asia can achieve similar results, if a similar economic community can be mooted. Should major economies such as China,

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<sup>14</sup> Bruce Russett, and John R. Oneal, "The Kantian peace: The pacific benefits of democracy, interdependence, and international organizations," *World Politics* 52, no. 1 (1999): 1-37.

<sup>15</sup> Hetty Musfirah Abdul Khamid, "Prosperity of Asia dependent on factors not economic in nature: PM Lee," *Channel NewsAsia*, April 11, 2015, Accessed May 5, 2015, <http://www.channelnewsasia.com/news/singapore/prosperity-of-asia/1777396.html>.

Taiwan, Japan and South Korea come together to form a coherent economic multi-lateral institution, there is a high chance that these countries can enjoy the economic benefits that AEC member states will share. Yet, such communities are not naturally formed, owing to various barriers that can discourage countries from associating into an economic community. This section will enumerate three major difficulties associated with national-level economic organizations. Every multi-member organization is prone to conflict among constituent members owing to different priorities, norms and domestic needs. ASEAN is no stranger to these issues. Specifically, the issues under discussion are: 1) the dumping of excess produced goods in other countries' markets; 2) the extent of protectionism that hinders full economic integration; and 3) undesirable labour-side effects caused by labour mobility.

### *Dumping*

Countries able to manufacture cheaper goods tend to export such goods overseas upon saturation of the local market, leading to greater competition and declining profitability of recipient country firms. This condition, known as dumping, is a recurrent problem found in economic zones with members being in different stages of economic development.<sup>16</sup> Assuming free trade and a country X with a strong comparative advantage in good A, compared to countries Y and Z, the latter two countries will experience an influx of good A from X, leading to an outcompeting of domestic producers in Y and Z who lack the level of efficiency needed to provide similar goods at more competitive rates. This has been a problem faced in various regions, whereby the movement of goods according to comparative advantage has meant a decrease in earnings from domestic industries, who are unable to compete with more efficient producers from other countries. As a result, this phenomenon of dumping causes domestic producers to be squeezed out of the production market, leading to negative effects on the economy's production capacity as a whole. Of greater salience in politics, the marginalization of local sectors in business can foment greater resentment and demands placed on the government to protect their interests better. Should the government heed this call and respond in favour of their businesses, the resultant

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<sup>16</sup> Thomas J. Prusa, "On the spread and impact of anti-dumping," *Canadian Journal of Economics/Revue canadienne d'économie* 34, no. 3 (2001): 591-611.



situation can be detrimental to the overall fabric of the regional outfit writ-large.

In ASEAN, this problem of dumping has been averted by negotiating and re-aligning comparative advantages while embracing the overall enhancing effects on consumer surplus. The ASEAN institution leverages greatly on such conciliatory negotiation mechanisms that aim to produce consensus among member states.<sup>17</sup> This minimizes any consequent disagreements that can impede successful policy implementation. According to an ANZ Bank analyst, the ASEAN countries will likely structure their economies to match their resource endowments, with Singapore and Malaysia developing “into service and financial hubs for the region” while Indonesia, the Philippines, Thailand and Vietnam move into middle-end manufacturing, while Myanmar, Laos and Cambodia, will leverage on its physical resources for lower-value manufacturing.<sup>18</sup> This indicates that no particular industry will see inefficient and large-scale production of any goods or services. Instead, countries largely avoid the narrow concentration of industrial efforts on similar products and focus on their niche areas of production. Hence, this reduces any surplus production needing to be ‘dumped’ in regional markets.

### *Protectionism*

Economic integration can be greatly hindered when member countries refuse to abide by agreed upon regulations permitting movement of goods and services across borders. This is commonly done by raising barriers to mobility, a practice officially known as protectionism. Traditional protectionist measures include tariffs and quotas on foreign imports, while modern protectionist measures typically involve regulations on product content requirements.<sup>19</sup> Countries may adopt protectionism so as to protect their domestic industries from more efficient foreign competitors, which may have repercussions on domestic employment. Another reason for protectionism may be to pander to business groups with powerful influence and ties with politicians.<sup>20</sup> Such businesses understandably do not wish to

<sup>17</sup> Amitav Acharya, “Ideas, identity, and institution-building: From the ‘ASEAN way’ to the ‘Asia-Pacific way’,” *The Pacific Review* 10, no. 3 (1997): 319-346.

<sup>18</sup> Patrick John Lim, “10 to 15 years before ASEAN economic community becomes fully integrated: ANZ,” *Channel NewsAsia*, April 24, 2015, Accessed May 1, 2015. <http://www.channelnewsasia.com/news/business/singapore/10-to-15-years-before/1805076.html>.

<sup>19</sup> The Economist, “Protectionism: the Hidden Persuaders,” *The Economist*, October 12, 2013, Accessed May 1, 2015, <http://www.economist.com/news/special-report/21587381-protectionism-can-take-many-forms-not-all-them-obvious-hidden-persuaders>.

<sup>20</sup> Anusha Chari and Nandini Gupta, “Incumbents and protectionism: The political economy of



see an erosion of profits, which competition brings about generally. Still, despite such justifications, protectionist measures militate against the creation of an integrated and accessible economic community. These barriers prevent free flow of goods and services from one country to another, contradicting the basic tenet of economic integration.

ASEAN countries have tackled this problem by collaboratively building consensus about the disavowing of protectionism. This was embodied most clearly in the communique released after the ASEAN Summit in 2015, whereby ASEAN affirmed its commitment to eliminating trade tariffs, of which nearly 96% have been eliminated.<sup>21</sup> Incrementally, every country has been reducing restrictions on competition in protected sectors such as banking, which is a major source of revenue for economies. The commitment to protectionism can be seen in agreements signed within the AEC, including the ASEAN Comprehensive Investment Agreement (ACIA). The ACIA institutionalizes each country's commitment to liberalize their business sectors and this has "eased restrictions to cross-border trade."<sup>22</sup> This is supplemented by the ASEAN Trade in Goods Agreement, a "legal framework to realize the free flow of goods within the AEC." Consequently, much progress has been made in the AEC, whereby more than "70% of intra-regional trade" now has zero tariffs across 80 sub-sectors.<sup>23</sup> With more time given, the rate of further liberalization is expected to increase given the continued commitment of political leaders to the AEC's cause.

### *Undesirable labor effects*

Labor movement can be both a source of benefit and conflict to the receiving society, which may not always embrace foreigner inflows. This poses a formidable obstacle to any plans for full-scale economic integration, since any failure to

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foreign entry liberalization," *Journal of Financial Economics* 88, no. 3 (2008): 633-656.

<sup>21</sup> Najib Razak, *Chairman's Statement of the 26<sup>th</sup> ASEAN Summit*, ASEAN Website, April 27, 2015, Accessed May 1, 2015. [http://www.asean.org/images/2015/april/26th\\_asean\\_summit/Chairman%20Statement%2026th%20ASEAN%20Summit\\_final.pdf](http://www.asean.org/images/2015/april/26th_asean_summit/Chairman%20Statement%2026th%20ASEAN%20Summit_final.pdf).

<sup>22</sup> ASEAN, *Thinking Globally, Prospering Regionally*, 6.

<sup>23</sup> Balboa, J.D & G. Wignaraja. "ASEAN economic community 2015: what is next?." *Asia Pathways*. December 12, 2014. Accessed May 1, 2015. <http://www.asiapathways-adbi.org/2014/12/asean-economic-community-2015-what-is-next/>.

permit free labour flow can go against a fundamental tenet of a shared economic community. In theory, free labour flow is beneficial because it can correct any asymmetry in the labour market by ensuring that workers move to where they are in demand from places where they are currently unemployed due to undersupply of jobs.<sup>24</sup> Furthermore, these workers are likely to have received education and training in their home countries prior to movement to other countries, being a big advantage to the latter. Such prior training greatly reduces the need to equip these workers with basic skills, a source of cost savings for the receiving country. However, labour factors, despite their advantages for the receiving economy, interact with socio-cultural cleavages at the same time. Locals may perceive foreigners to be taking their jobs, fomenting greater resentment as a result. How have affected ASEAN countries dealt with this? To provide a more detailed analysis, here this paper examines a single case, Singapore, in detail.

Being an advanced economy, Singapore is attractive to many foreign workers around the world. This ranges from lower-value employment such as in construction and the service industry, of which most workers tend to be from neighbouring ASEAN countries and South Asia, to high-value employment in sectors such as banking and Information Technology (IT).<sup>25</sup> Such workers can come from any part of the world, with the critical distinction being their professional qualifications and experience. Due to rapid development, alignment with comparative advantage, and a small labour force, Singapore has relied on foreigners to fill gaps in the various sectors, with most of them found in the lower-value sectors.<sup>26</sup> The reason for this is that, since Singapore's only valuable resource endowment is human capital, such capital must be upgraded to be of higher value in order to sustain the economy's development.<sup>27</sup> As such, labour shortages are found more in the sectors of construction and ancillary public services such as cleaning.

However, Singaporean society has not taken well to such measures and has displayed occasional resistance to the foreign labour policy of the government.

<sup>24</sup> Marc Lieberman and Robert Hall, *Economics: Principles and Applications*, (Australia, South-Western: Cengage Learning, 2013).

<sup>25</sup> Brenda SA. Yeoh, "Bifurcated labour: the unequal incorporation of transmigrants in Singapore," *Tijdschrift voor economische en sociale geografie* 97, no. 1 (2006): 31.

<sup>26</sup> Chew Soon-Beng and Rosalind Chew, "Immigration and foreign labour in Singapore," *ASEAN Economic Bulletin* (1995): 191-200.

<sup>27</sup> Neo Boon Siong and Geraldine Chen, *Dynamic Governance: Embedding Culture, Capabilities & Change in Singapore*, (New Jersey: New Scientific Press, 2007).

This has sometimes translated into strong pressure on elected politicians to manage the policy better by slowing down the rate of uptake. As society's support is essential to any public policy, the state is unable to ignore public opinion. To this end, Singapore has been more careful and calibrated in its approach to foreign worker inflows. There are categories of employment that require different skill sets, and are open to different nationalities.<sup>28</sup> In labour intensive sectors, the government does not appear to be intervening extensively, since such labour flows are transient and do not significantly pose problems to society. For the professional sectors, depending on deemed merit and worthiness, foreigners are eligible for Permanent Resident status or Singaporean citizenship itself. It is in this domain that discernible change is apparent, with majority beneficiaries being other ASEAN countries, while those from South Asia and other regions are in the minority. In 2013 for example, 55.3% of new PRs were from ASEAN countries while 34.6% came from other Asian countries such as India and China.<sup>29</sup>

On the societal frontier, the government has become more active in its drive to clarify the misconceptions related to foreign workers taking jobs away from locals, backed up with actual policies to lend such messages more credence. For example, companies must list openings for certain jobs one month prior to opening them up to foreigners.<sup>30</sup> In addition, the number of foreign workers allowed for hire by a company is determined by a pre-set ratio of local to foreign labour.<sup>31</sup> This means that firms must hire local workers before they can be allowed to hire foreigners. Together, these policies aim to assuage public concerns by showing that the government is monitoring labour inflows and ensuring no undesirable side effects on society writ large. This is a strategy that dovetails with larger AEC goals. Singapore has continued to privilege AEC partners in its for-

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<sup>28</sup> Yeoh, "Transmigrants in Singapore."

<sup>29</sup> National Population and Talent Division, Prime Minister's Office [Singapore], 2014 *Population in Brief*, accessed May 1, 2015, <http://www.nptd.gov.sg/portals/0/news/population-in-brief-2014.pdf>.

<sup>30</sup> Teo Xuanwei, "Firms must now post job listings for Singaporeans on MOM site," *TODAY Newspaper*, September 23, 2013, Accessed May 5, 2015, <http://www.todayonline.com/singapore/firms-must-now-post-job-listings-singaporeans-mom-site>.

<sup>31</sup> Toh Yong Chuan, "Budget 2013: foreign worker levies to go up, quotas for services and marine sectors cut," February 25, 2013, Accessed May 5, 2015, <http://www.straitstimes.com/breaking-news/singapore/story/budget-2013-foreign-worker-levies-go-quotas-services-and-marine-sector>.

eign labour policies, as seen in the above proxy indicator of majority ASEAN PR and citizenship grants, supporting the AEC's eventual ideal of free labour mobility. In this regard, there are positive steps being taken to ensure that, despite societal resistance, Singapore's cooperation and compliance with AEC goals are not compromised, but have been managed in order to ensure smooth policy development and acceptance.

## II - NORTHEAST ASIA'S LEARNING FROM THE ASEAN EXPERIENCE

### Northeast Asia and Southeast Asia

The Northeast Asia region is usually seen as disparate from Southeast Asia in terms of traditions, economics, and international relations. Yet there exist some key similarities between the two regions. In today's geopolitical context, the Northeast Asia region includes Japan, Taiwan, North Korea, South Korea and China. These countries are largely different in scale, as well as economic and political power. Also, the countries are of different levels of development with countries like Japan ranked among the most developed nations in the world, China as a rising industrial economic power, and countries such as North Korea ranked among the least developed nations in the world.<sup>32</sup> This condition of different stages of development is similar to Southeast Asia, where countries can also be approximately classified as belonging to different levels of economic development and factor endowments.

The different stages of the Northeast Asian states' economic development indicate that they can also benefit by re-aligning their economic bases according to their comparative strengths, just like AEC countries could do. China like has a large labour force, allowing it to have a comparative advantage in labor-intensive industries. South Korea and Japan have advanced industrial technologies, although the costs of production are markedly higher than in neighbouring countries. But greater alignment according to their comparative advantage in high value technology goods will benefit the region through specialization and trade. However, free trade is still a work-in-progress, since the current regional trade system in Northeast Asia is characterized by significant transaction costs in terms of tariffs and legal restrictions.<sup>33</sup> This reduces the region's collective productivity and lowers

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<sup>32</sup> Kent Calder and Min Ye, *The Making of Northeast Asia*, (Stanford: Stanford University Press, 2010).

<sup>33</sup> Ramesh Chand, *Free Trade Area in Asia*, (Academic Foundation, 2006).

the efficiency of resource allocation. Northeast Asian countries ought therefore to re-align their economic means of production according to their comparative advantages, as the AEC has managed to do. In this manner, countries can benefit from exchange of production factors such as labour and also intermediate and final goods and services. This will increase the whole region's productivity and economic efficiency, ultimately benefitting all member states' societies in the long run through more sensible resource allocation.

Secondly, an NAEC will benefit from the same enlarged consumer market size, as has been the case for ASEAN. Theoretically, the benefits for the former should be similar to the latter. For example, there will be greater foreign direct investment inflow, since investors usually favor an integrated market that is much larger and potential. Northeast Asia is even larger than Southeast Asia in economic scale. The effects will be even more significant in Northeast Asia due to its large demographic size of 1.5 billion people, accounting for 20% of the world's population (Seliger, 2002). This NAEC integrated market will increase the region's competitiveness as a whole against the rest of the world. The integrated consumer markets also allow companies to generate more values, while benefitting the people in the form of greater product variety, lower prices and higher incomes from shared economic growth.

Thirdly, an economic community can help to maintain regional peace and ameliorate security-related challenges in Northeast Asia. Just as the presence of the AEC has provided positive security externalities against unnecessary regional conflicts, a common economic community can effectively reduce political tension and ensures peace in Northeast Asia. The economic interdependence theory explains that as two countries become more economically interrelated while trade increases and economic connections deepen, it is less likely for conflicts to break out between the two states. Economic interdependence increases social interdependence, making countries more closely connected with one another and increasing the cost of conflict. In Northeast Asia, the use of economy to promote peace is not new. China has long sought to increase its economic interdependence with Taiwan, hoping to achieve reunification in the future.<sup>34</sup> It welcomes Taiwanese businessmen to invest in Mainland China and has also

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<sup>34</sup> Douglas B. Fuller, "The Cross-Strait economic relationship's impact on development in Taiwan and China: Adversaries and partners," *Asian Survey* 48, no. 2 (2008): 239-264.

signed many economic cooperation agreements with Taiwan. The increasing economic interdependence across the strait has been very effective in improving the amity and stability between the two. In fact, many scholars have argued that closer economic relations between North and South Korea is the more promising option in achieving reunification.<sup>35</sup> Integration into one economic community can in this way promote better relations between different Northeast Asian countries and stabilize the region.

### AEC lessons in Northeast Asia

As discussed above, the three main problems encountered during the process of creating AEC are: 1) the dumping of excess produced goods in other countries' markets; 2) the extent of protectionism that hinders full economic integration; and 3) undesirable labour-side effects caused by labour mobility. Because of the similarities between Southeast Asia and Northeast Asia, these problems can also be expected when creating the Northeast Asia economic community. The lessons learnt by AEC are thus highly valuable to Northeast Asia and can serve as suitable guidelines steering the latter towards integration.

Dumping is one of the most serious concerns when countries establish free trade ties. Countries able to manufacture goods at much lower prices tend to export such goods to foreign markets for more sales. Because of their cost leadership, they are able to out-compete less efficient producers from the receiving country, leading to structural unemployment and a tandem rise in animosity towards the exporting country. Dumping is a perennial concern among many countries in Asia.<sup>36</sup> In Northeast Asia, China's low labor cost and abundant manufacturing capabilities have allowed it to have a comparative advantage in production of materials such as steel, which has been argued to be 'dumped' in the European and American markets. In the AEC, this problem of dumping has been averted by negotiating and re-aligning comparative advantages while embracing the overall enhancing effects on consumer surplus. As countries re-align themselves according to competitive advantages, they will not compete with others in their less efficient industries. They avoid narrow concentration of industrial efforts on similar products and focus on their niche areas of production. This

<sup>35</sup> Koh, Il-Dong. "Korea's reunification from the perspective of Northeast Asia's economic integration." *Journal of Economic Integration* 27, no. 2 (2012): 274-279.

<sup>36</sup> Prusa, "Anti-dumping."

reduces any surplus production needing to be ‘dumped’ in regional markets. Inefficient producers should be incentivized to divert their capital to other industries in which the country can build a comparative advantage. If Northeast Asia is able to delineate industries they are most suited for economically, then the long-term benefits of greater economic integration will outweigh the short-term costs, such as structural unemployment.

Protectionism is another issue hindering the successful implementation of economic community. When member countries refuse to follow economic agreements and restrict entrance of foreign goods and services, they largely reduce the efficiency of the whole community. These trade barriers prevent free flow of goods and services and endanger the foundation of economic integration. Countries may use protectionism to protect domestic industries from foreign competitors or because of lobbying by business groups with powerful influence and ties to politicians.<sup>37</sup> Japan has frequently set up import restrictions on goods made in China and prevented foreign competition in sectors such as the consumer groceries sector. A relevant lesson from the AEC is how all member countries have collectively developed a consensus to disavow protectionism, based on comparative advantage logic. As earlier mentioned, member states have signed various agreements to prevent protectionist actions by any member state towards others in the AEC. If Northeast Asia can collectively reject the use of protectionism policies, disregarding protectionism’s political popularity, the regional consensus can increase the likelihood of an NAEC’s establishment.

The other problem is uncontrolled labor movement within the economic community. In theory, free labour moves from places where they are currently unemployed or lower paid to other places with better job prospects (Lieberman and Hall, 2013). When foreign workers, especially low skilled workers with limited education, enter a society largely different from theirs, they are unlikely to integrate well in the host society for reasons such as cultural differences. In addition, some locals tend to see foreigners as unnecessary competitors fighting for the same jobs that they need. For example, Chinese immigrant workers have caused some conflicts and discontentment in various Japanese and South Korean cities that they work in. In AEC countries like Singapore, this problem is overcome by careful planning by the government. The Singapore government actively monitors the amount of foreign labor needed in each industry, thereby ensuring there

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<sup>37</sup> Chari and Gupta, “Incumbents and protectionism.”



is a local-foreign job balance that does not alienate its own citizens, while still benefitting from the skills and experience that foreign workers bring along with them. This experience is very helpful to the Japanese government when creating NAEC, since controlling the rate of Chinese worker entry sends a signal to citizens that the government is aware of the associated problems and is actively managing the issue. Greater acceptance of foreign workers within Northeast Asia, while requiring incremental and gradual efforts, is a desirable outcome that will facilitate the chances of regional economic integration.

### Other Problems in Creating a Northeast Asia Economic Community

The problems experienced by Southeast Asia can help Northeast Asia better plan the creation of their own economic community. But there are also some unique Northeast Asian problems that have not been experienced by the AEC, which may still need to be addressed. This paper will not engage these alternative problems in detail, since the focus is on the path towards greater economic integration. While resolving these issues can promote the growth of an NEAC, it is equally viable that this causality may be *reversed*. Greater economic integration, perhaps, can provide the preliminary basis for Northeast Asian countries to work these other issues out.

The first problem is the lack of formal political institutions in Northeast Asia to facilitate the creation and functioning of a common economic community. The notion of establishing an NAEC was initially floated in 2001, when South Korea president Kim Dae-Jung raised the idea of a regional economic community.<sup>38</sup> However, this idea has never been achieved. Leaders of Northeast Asian countries mention it almost every year, but there remains no concrete plans for such a community yet. In Southeast Asia, the structure of ASEAN is very important as it creates necessary institutions and platforms for all countries to discuss their individual interests and reach agreements. However, there is no comparable regional organization encompassing all Northeast Asian countries. Still, there are existing regional platforms that can be leveraged upon to provide the medium for negotiation. For example, the East Asia Summit, established by Japan, is a suitable arena for all stakeholders to participate in. The ASEAN+3

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<sup>38</sup> Bernhard Seliger, "Economic integration in northeast Asia: Preconditions and possible trajectories," *Global Economic Review* 31, no. 4 (2002): 17-38.

summit, which includes all ASEAN states, China, Japan and South Korea, is another prospective platform that can facilitate discussions and work out differences between these three largest Northeast Asian states.

Secondly, the inter-state politics of Northeast Asia is much more complicated than that of Southeast Asia. The United States, as a major actor in Northeast Asia, engages in multipolar policy in the region under a 'hubs and spokes' model, in which all countries are bilaterally tied to the U.S.<sup>39</sup> Hence, it will be difficult for states allied to the U.S, namely Taiwan, South Korea and Japan to act without American support. Nonetheless, although this barrier to economic integration is significant, it is not by any means insurmountable. As the American government has indicated on various occasions, it welcomes China to play a larger role in the region, although subject to the latter abiding by international rules and regulations. If China is able to indicate its commitment to upholding such institutions, then American support may be forthcoming, raising the chances of economic integration. Economic integration will benefit the said countries, which should therefore merit American support, assuming the U.S truly wants to help its allies economically develop. Should the U.S value political goals more than the material interests of its Asian allies, then there exists little reason for Taiwan, South Korea and Japan to forsake material benefits simply to please the American government. The logic of economic integration, if objectively presented, provides Northeast Asian states with more economic benefits, at the expense of minor political cost.

Thus far, economic integration has been proposed as a way to enhance the economies of the various Northeast Asian states, according to various theories such as the model of comparative advantage. While there are various barriers in Northeast Asia that can hinder the development of an economic community, it has been argued that such barriers are surmountable, given sufficient political will. The benefits from economic cooperation can provide reasonable grounds for member countries to work towards resolving their political differences, since it is only from doing so that an economic community can hope to be sustained and strengthened over time. Following economic liberalism theory, greater mutual interdependence through an economic community can provide states with

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<sup>39</sup> John G. Ikenberry, "American hegemony and East Asian order," *Australian Journal of International Affairs* 58, no. 3 (2004): 353-367.

the motivation and the mechanism to resolve their problems, thereby increasing the attractiveness of an NAEC.

### III – BEYOND NORTHEAST AND SOUTHEAST ASIA: THE FUTURE OF PAN-EAST ASIAN ECONOMIC INTEGRATION

The successful creation of an NAEC, alongside the AEC, can be powerful drivers of a more closely integrated East Asia. The enhanced preponderance of East Asia as a counterweight to other major economies in the world can augur in an even more formidable era of collective economic gains to member economies. Fortunately, the possibilities of doing so are not without existing mechanisms to utilize, with the most important of all being the ASEAN+3 outfit as mentioned in an earlier section. This potential platform for cross sub-regional ties formation will be expounded on, following some preliminary thoughts on the issue's salience.

The creation of an 'East Asian Economic Community' can provide for a more stable and peaceful environment for member countries in East Asia. This can be useful in moderating the degree of conflict among member nations. Different communities of people may seek association (and dissociation) on the bases of primordial affiliation, ideology, security interests or economic ties. An East Asian Economic Community may pose the most unproblematic means for East Asian states to associate in this realm of affairs. The other means of association do not appeal to these countries for the following reasons. Primordially, Samuel Huntington identified different civilizations in the Asia region.<sup>40</sup> For example, much of the Sinic civilization is different from the Japanese civilization. In Southeast Asia, the two main Austroasiatic and Austronesian groupings are even further apart from these civilizations in Northeast Asia, than they are in relation to each other.<sup>41</sup> What this indicates is that the "imagination" of a community, following Benedict Anderson proves more difficult since cultural stocks are largely different.<sup>42</sup> Ideologically, Asia is noted for its diversity of political systems and structures that closely follow behind. Fareed Zakaria classifies Singapore and Malaysia as "illiberal democracies"; North Korea and China remain communist states; Taiwan and Japan are liberal de-

<sup>40</sup> Samuel P. Huntington, *The Clash of Civilizations and the Remaking of World Order* (New York: Simon & Schuster, 2008).

<sup>41</sup> Clark D. Neher, *Southeast Asia: Crossroads of the World* (DeKalb: Northern Illinois University Press, 2010).

<sup>42</sup> Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism* (London: Verso Books, 2006).

mocracies; and Thailand and Myanmar are influenced by military rule.<sup>4344</sup> Since ideology proves a polarizing issue amongst peoples, as Andrew Heywood notes, it is expected that ideological association cannot be satisfactorily achieved.<sup>45</sup> In the aspect of security, the particular nature and organization of intra-regional state-to-state relations militate against any semblance of collective security arrangements or cooperation. More specifically, this is due to the maintenance of the 'hubs and spokes' model, which links Japan, South Korea and Taiwan close to the United States, with China perceived as a competitor for power in the region.<sup>46</sup> China's increasing military power can provoke a Hobbesian response from Japan, Taiwan and South Korea. This is due to the insecurity, as realists posit, that the latter three countries feel about China's 'aggression.'<sup>47</sup> Furthermore, the presence of the United States, with its strong bilateral alliances with Japan and South Korea, renders any regional security ties foreseeably unfeasible. As such, security interests also fail to provide a common platform for cooperation.

It is in this regard that economic ties prove most valuable for giving East Asian states some cause to seek association. Following the wave of globalization, every East Asian state (save for North Korea) has successfully integrated into the global economy as willing and active participants. Insofar as every actor in the association is guaranteed and receives the economic benefits promised under the organization's collaboration, there are clear game-like and straightforward ways of seeking assurance that cooperation is being valued over competition. Economics today largely follow the global liberal market model, rendering all participants familiar with such an idea. This is important, since such familiarity through an active participation in the global economy organized along these lines ensure that all participants are clear about the processes and outcomes involved, making the tasks of monitoring easier to accomplish. Consequently, there is less likelihood of suspicion arising, vis-à-vis security cooperation.

<sup>43</sup> Fareed Zakaria, "The rise of illiberal democracy," *Foreign Affairs* (1997): 22-43.

<sup>44</sup> Myanmar appears to be transiting towards a more democratic political system, following elections held in 2015. Nonetheless, the military still wields considerable influence as many legislative seats are reserved for the army.

<sup>45</sup> Andrew Heywood, *Political Ideologies*. (Basingstoke: Palgrave Macmillan, 2012).

<sup>46</sup> Victor D. Cha, "Powerplay: Origins of the US alliance system in Asia," *International Security* 34, no. 3 (2010): 158-196.

<sup>47</sup> June Teufel Dreyer, "China's power and will: The PRC's military strength and grand strategy," *Orbis* 51, no. 4 (2007): 651-664.

Still, a reminder is in order – nationalism appears to be a powerful force driving the behaviors and actions of many societies in Asia, which is not altogether a positive development for economic integration. As Singapore's Prime Minister Lee Hsien Loong shared, his biggest worry for Singapore today is a growing nationalism in the region<sup>48</sup>. This is not threatening to Singapore alone, for clearly nationalism poses a danger to inter-state relations in the entire Asia region. For example, Japan and China continue to experience friction over wartime-related activities during World War II.<sup>49</sup> while the Philippines and China are also locked in a dispute over ownership of various islands in the South China Sea. These are inductive examples, but their repercussions on the region resound clearly and need to be well managed. Where irrational emotions and actions can be galvanized by the politicization of such psychological and nationalistic issues, the threat posed to economic integration is also considerable. As such, governments need to actively manage these issues, to prevent the threat of nationalistic rhetoric from derailing economic cooperation.

But a successfully created East Asian economic community will be of benefit to all member countries, should the above obstacles be resolved. The production base of East Asia's economy will be the aggregate of the AEC and the NAEC - greater movement of goods and capital can facilitate even more cohesive and mutually beneficial economic growth; and East Asia can also institutionalize a regional trading block rivaling those in Europe or North America, assuring it of greater gains than before. Where cooperation can be sought in the realm of economy, it is also conceivable that there are other effects that can enhance the overall attractiveness of integration. This is the ability to utilise economy as a platform for trust and confidence building, the successful outcome of which may serve the moderation of nationalistic tendencies and friction among states over territory or historical experiences. This is by no way easy, evidenced from Japan's ongoing dispute with China in spite of economic ties.<sup>50</sup> But this is precisely why we have highlighted the need for both sides, perhaps, to take reference from ASEAN's resort to negotiation and consensus building. Through peaceful and constructive dialogue, a common agreement on economic cooperation is not necessarily hindered by issues related to politics and culture as well. As such, every country in East Asia should play a

<sup>48</sup> Khalid, "PM Lee."

<sup>49</sup> He Yinan, "History, Chinese nationalism and the emerging Sino-Japanese conflict," *Journal of Contemporary China* 16, no. 50 (2007): 1-24.

<sup>50</sup> Ibid.

larger part in looking beyond short-term political interests and seek genuine long term gains which can only benefit all in the society. The object of government is to secure the greatest welfare for the greatest number of its citizens. This is an outcome an East Asian Economic Community may help to secure and it will rest *a priori* on the successful creation of the AEC and NAEC.

The presence of ASEAN+3 is a useful mechanism for coordinating the further integration of these two regions, since it is an institution with representation from both sub-regions. ASEAN+3 refers to all ASEAN member states, in addition to China, Japan and South Korea. Through this institution, East Asia as a whole can begin this task of seeking economic integration cross sub-region, if this is an end that all countries desire. Some successes have been evident, such as how greater financial cooperation was achieved in 2003 whereby the “number of bilateral [currency] swap arrangements” across the member countries doubled.<sup>51</sup> Other than its role as a clearing house for information among regional leaders, it also serves as a site for negotiation and subsequent shaping of shared interests, which can be vital to any pact’s successful implementation and continuation. But an East Asian Economic Community still remains a long term ideal: in the short to middle term, effort should be devoted towards creating a durable and beneficial NAEC that enjoys buy-in from all member countries. Thereafter, the potential for an East Asia-wide equivalent can then be more concretely explored.

## SUMMARY AND CONCLUSION

The ASEAN Economic Community provides a very good example of how successful economic integration in a diverse region can be pursued. An integrated economic regional outfit provides both powerful economic benefits and security externalities, which are goals that the AEC can help advance. Northeast Asia can also benefit from the creation of a Northeast Asian Economic Community, as earlier mentioned. To pave the way for success, three lessons can be gleaned and adapted by Northeast Asia to enhance an economic community’s viability. To that end, ASEAN’s emphasis on negotiation and consensus building has helped them to pursue economic integration. Specifically, the AEC’s ability to reduce

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<sup>51</sup> H Soeastro, “An ASEAN Economic Community and ASEAN+3: how do They Fit Together?” *Pacific Economic Papers*, 338, 2003. <https://digitalcollections.anu.edu.au/bitstream/1885/41965/2/pep-338.pdf>.

the obstacles of dumping, protectionism and problems associated with mobility of labour were discussed. These are lessons relevant to Northeast Asia.

Based on the essential similarities between Northeast Asia and Southeast Asia, the benefits enjoyed by the latter can also be expected in Northeast Asia if a similar economic community is created there. The lessons learnt from AEC in dealing with dumping, protectionism, and unregulated labor movements are valuable experiences for Northeast Asia. Yet, the region has some unique problems that need to be resolved in order for an integrated economic community to be created. These problems include the lack of regional political institution and complicated international relations. Still, these problems can be resolved if member states can constructively utilise existing platforms, such as the East Asian Summit and the ASEAN+3 Summit. This paper has deliberately not engaged the political dimension of inter-state relations in detail, since much scholarly effort has been devoted towards explaining this aspect of the region's relational dynamics. Instead, this paper has sought to argue that economic integration can be a major stepping-stone that supplies and reinforces the logic of cooperation and regional peace. The economic route to regional stability may not come without its own limitations. However, in the absence of more feasible alternatives that are empirically superior, economic integration stands out as an option with great promise for future East Asian relations. If economics can facilitate regional peace, incentivize member states to set aside political differences and help to raise their collective societal happiness, then Northeast Asia should work towards greater economic integration – with some help from the AEC on how economic disputes can be reconciled through consensus building and concordant political will.

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