

CHAPTER I

INTRODUCTION

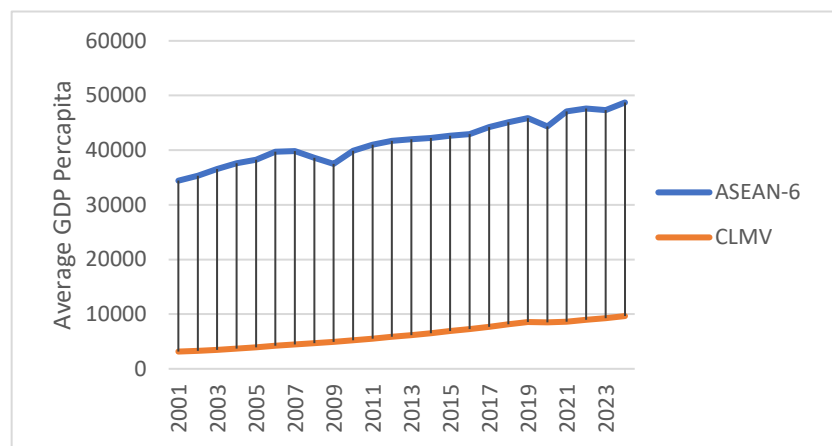
1.1 Background

The Association of Southeast Asian Nations (ASEAN) is one of the regional areas in the developing world that has undergone relatively rapid economic transformation in recent decades (Park, 2024). This region has become a new center of economic growth in Asia, characterized by an increase in intra-regional trade, foreign investment flows, and the strengthening of regional economic cooperation. ASEAN's strategic role in the global economy is also reflected in its contribution to regional economic growth in Southeast Asia and its position as a primary investment destination for both developing and developed nations (Chizema, 2025).

However, amidst these growth dynamics, the economic development process within the ASEAN region exhibits non-uniform characteristics among its member states. According to Feeny (2025), ASEAN is characterized by high heterogeneity with striking socio-economic development disparities across its members. Concerns regarding the emergence of a "two-tier ASEAN" have intensified since the accession of Cambodia, Laos, Myanmar, and Vietnam (the CLMV group) into the organization between 1995 and 1999. These newer member states recorded more significant poverty levels and weaker institutional structures compared to the six founding members, or ASEAN-6. This initial imbalance reflects a major challenge in distributing prosperity equitably throughout the Southeast Asian region. This development gap is most clearly visible through per capita income indicators, where the difference between high-income countries and developing

nations in the region remains wide, despite the CLMV countries generally experiencing relatively high economic growth rates over recent decades. Beyond the income dimension, this inequality also encompasses other multidimensional aspects such as human resource quality, institutional effectiveness, infrastructure availability, and competitiveness levels (Kwan & Malki, 2025).

Figure 1. 1 Average GDP Percapita ASEAN-6 vs CLMV 2001-2024



Source: World Bank, 2024

Based on Figure 1.1, which illustrates the Average GDP Per capita of ASEAN-6 vs CLMV for the 2001-2024 period, it is visually evident that a substantial and persistent income gap exists between the two groups of countries. Although the income curve for the CLMV group shows a steady upward trend, the position of the ASEAN-6 curve confirms that the occurring economic growth has not yet been able to significantly close the inequality gap. This phenomenon of persistent income inequality poses a real challenge in development economics, as it indicates that the benefits of regional economic growth have not been fully integrated or equitably distributed across all layers of the member states.

In response to the persistent development disparities in the region, ASEAN initiated various regional economic integration frameworks, where the ASEAN Free Trade Area (AFTA) is positioned as one of the primary instruments in fostering intra-regional trade integration. AFTA is not merely a technical trade policy, but rather an economic instrument designed to strengthen ties between member states through market liberalization. By integrating previously fragmented domestic markets into a single regional production base, ASEAN aims to create a greater attraction for foreign investment and strengthen the region's bargaining position in the global market (Oktavia & Verico, 2020). The primary objectives of AFTA's implementation are to increase intra-ASEAN trade volume, promote economic efficiency through specialization, and accelerate inclusive economic growth throughout the region. Through the elimination of tariff and non-tariff barriers, trade transaction costs between member states are expected to decrease significantly, which in turn will stimulate economic activity in developing nations. This process is viewed as a crucial mechanism for lower-income countries to gain broader market access and absorb technology transfers from more advanced member states (Kyophilavong & Hayakawa, 2023).

The process of trade liberalization within the AFTA framework is implemented gradually through the Common Effective Preferential Tariff (CEPT) scheme. Along with the deepening of intra-ASEAN trade integration, the CEPT scheme was subsequently refined through the ASEAN Trade in Goods Agreement (ATIGA), which came into effect in 2010 with a broader scope, including the reduction of non-tariff barriers and trade facilitation. This approach provides time

flexibility for each member state to perform structural adjustments to their domestic economies, particularly for newer members with differing industrial capacities.

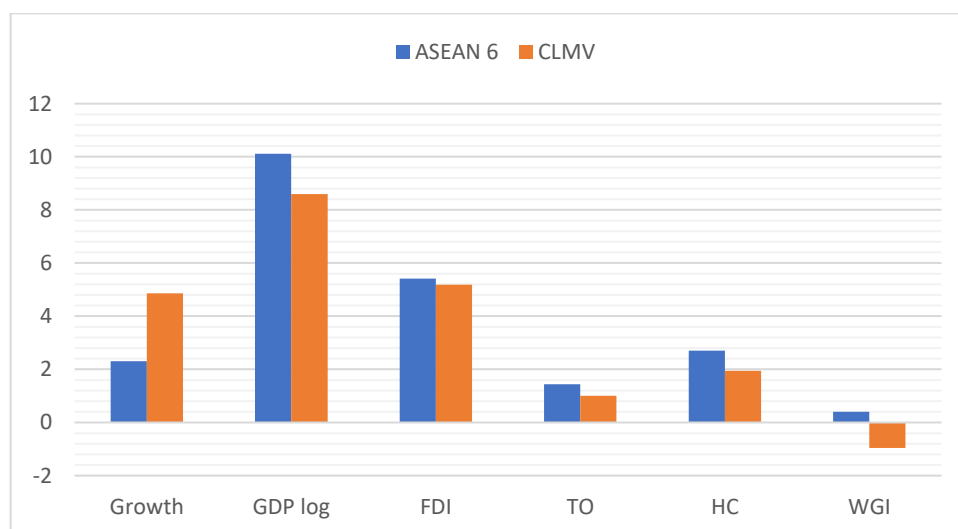
This integration policy is positioned as a solution to narrow the development gap by ensuring that the economic benefits of market openness can be felt by all members without exception. Through consistent tariff reduction commitments, ASEAN hopes to create economic convergence where CLMV countries can grow faster to catch up with the ASEAN-6. This deepening integration dynamic then raises a fundamental empirical question whether trade liberalization through AFTA truly contributes to narrowing the income gap among member states, or if the benefits are not distributed equitably across the region (Feeny, 2025).

In the context of regional integration, trade openness through AFTA should accelerate this process by facilitating capital flows and technology transfers, which will eventually lead member states toward a steady state or a similar level of economic equilibrium (Seti et al., 2025). Nevertheless, literature on regional economic integration suggests that the benefits of trade liberalization are not always distributed symmetrically (Chizema, 2025). Trade and investment flows tend to concentrate in countries with higher absorptive capacity, such as better infrastructure quality, superior human resources, and established institutional stability. Consequently, instead of narrowing the gap, economic integration risks reinforcing the dominance of economically advanced nations and leaving low-capacity countries further behind. This condition sparks a debate on whether integration will result in income convergence or instead widen economic divergence among member states (Gammadigbe, 2021). The role of AFTA in

income convergence is an empirical question that cannot be theoretically assumed and requires direct testing by controlling for other structural factors.

This debate is inseparable from the differences in structural characteristics possessed by ASEAN member states. Figure 1.2 presents a comparison of several key structural indicators between the ASEAN-6 and CLMV groups, reflecting the heterogeneity of economic capacity in the region. In general, ASEAN-6 countries possess relatively higher levels of per capita income, foreign investment inflows, human resource quality, and governance quality compared to CLMV countries. Conversely, the CLMV group records higher GDP per capita growth rates, reflecting the potential for a catch-up process from lower initial income levels.

Figure 1. 2 Comparison of ASEAN-6 and CLMV Indicators



Source: Data processed from World Bank, Penn World Table (11.0), and Worldwide Governance Indicators (2024).

Differences in these structural indicators indicate that the capacity of ASEAN countries to utilize economic integration and trade openness is not homogeneous. Countries with a strong industrial base and established institutional stability tend to

be better prepared to exploit opportunities from economic integration compared to countries that still rely on the primary sector. These disparities in structural capacity raise concerns that trade integration could actually reinforce the dominance of advanced nations and create a "winners and losers" phenomenon within the region (Anasta & Sylviana, 2024).

Although economic integration through the removal of trade barriers has the potential to accelerate the catch-up process for lagging countries, the ultimate outcome is often conditional. The theory of conditional convergence suggests that while member states may experience growth, they tend to move toward different steady-state equilibrium levels, depending on their unique characteristics. Therefore, the debate over whether ASEAN is heading toward a unified level of welfare or becoming increasingly fragmented into a two-tier system remains a complex issue that requires profound empirical evidence.

Empirical studies regarding income convergence in the ASEAN region have expanded rapidly in recent years. Most studies focus on testing the existence of convergence; for instance, Kwan & Malki (2025) found that convergence does occur in ASEAN but is slow and forms a two-tier pattern between the ASEAN-6 and CLMV, while Feeny (2025) emphasized that convergence remains limited due to high structural heterogeneity. Regarding explanatory factors, Suprayitno & Gitaharie (2025) found that human capital acts as a catalyst for conditional convergence in ASEAN-8, whereas Magazzino et al. (2022) demonstrated that globalization drives conditional convergence. Conversely, Eum & Maliphol (2023) found that the convergence of trade structures contributes to the economic catch-up

process in Southeast Asia, and Nam & Ryu (2024) asserted that trade openness promotes growth, though its effects are non-uniform across countries.

Nevertheless, three significant gaps remain inadequately addressed in the existing literature. First, the majority of convergence studies in ASEAN are limited to testing the existence of the phenomenon without explicitly integrating the role of regional trade integration, particularly AFTA, as an explanatory variable. Second, structural factors such as FDI, trade openness, human resource quality, and institutional quality are more frequently analyzed in the context of economic growth rather than the speed of income convergence between countries. Third, empirical evidence regarding the impact of integration through AFTA on income convergence remains limited, with inconsistent results across studies. This research aims to fill these three gaps by testing both absolute and conditional β -convergence, while positioning trade integration through AFTA and structural factors as explanatory variables within an integrated analytical framework.

Based on the background described, there are several key issues that serve as the focus of this research. First, there remains a persistent per capita income gap among ASEAN countries despite the regional economic integration process having lasted for a relatively long period. Second, the prediction of income convergence theory is not yet fully reflected in the empirical reality of the ASEAN region, raising questions about the nature of the convergence taking place. Third, economic integration through the ASEAN Free Trade Area (AFTA) has not been clearly proven to play a role in accelerating the narrowing of the income gap among member states, especially amidst high structural heterogeneity. Therefore, this

research is focused on empirically examining whether income convergence truly occurs in ASEAN, whether the process is absolute or conditional, and whether trade integration through AFTA is statistically proven to be related to the income convergence process among ASEAN member states after controlling for other structural factors.

1.2 Problem Formulation

Based on the background described above, the research questions for this study are as follows:

1. Is there absolute income convergence among ASEAN countries during the 2001–2024 period, as indicated by the effect of initial GDP per capita on GDP per capita growth?
2. Is there conditional income convergence among ASEAN countries during the 2001–2024 period, as indicated by the effect of initial GDP per capita, AFTA, FDI, trade openness, human capital, and institutional quality (WGI) on GDP per capita growth?

1.3 Research Objectives

The objectives of this research are:

1. To analyze absolute income convergence by examining the effect of initial GDP per capita on GDP per capita growth as variable Y among ASEAN countries during the 2001–2024 period.

2. To analyze conditional income convergence by examining the effect of initial GDP per capita, AFTA, FDI, trade openness, human capital, and institutional quality (WGI) as variables X on GDP per capita growth among ASEAN countries during the 2001–2024 period.

1.4 Research Scope

This research is limited to ASEAN member states with an observation period from 2001 to 2024. The primary focus of the analysis is income convergence, measured using GDP per capita. Economic integration is represented through the existence of AFTA as the framework for intra-regional trade liberalization. The variables analyzed include per capita income, economic growth rates, and supporting variables used in testing conditional convergence. This study does not discuss in detail the sectoral impacts of AFTA or non-economic aspects outside the framework of economic growth and income convergence.

1.5 Research Benefits

In general, this research provides the following benefits:

1. **Policy Significance:** The results of this study can serve as a consideration for policy makers in the ASEAN region in designing economic integration policies that not only promote growth but also take into account the differences in structural capacities among member states.
2. **Academic Significance:** This research is expected to contribute to the literature on development economics and international trade, specifically regarding economic convergence and regional integration in developing countries.

3. Practical Significance: To serve as a reference for researchers and stakeholders interested in the issues of economic integration, convergence, and regional development in developing countries.